

1991

U.S. West Communications, Inc. v. Public Service  
Commission of Utah; Brian T. Stewart, Chairman,  
James M. Byrne, Commissioner, Stephen F.  
Mecham, Commissioner : Brief of Respondent

Utah Supreme Court

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IN THE SUPREME COURT OF THE STATE OF UTAH

U S WEST COMMUNICATIONS, INC.

Petitioner,

vs.

PUBLIC SERVICE COMMISSION OF  
UTAH: Brian T. Stewart, Chairman,  
James M. Byrne, Commissioner,  
Stephen F. Mecham, Commissioner,

Respondents.

Case No. 910408

Argument Priority No. 10

BRIEF OF RESPONDENTS UTAH PUBLIC SERVICE COMMISSION, DIVISION  
OF PUBLIC UTILITIES, COMMITTEE OF CONSUMER SERVICES,  
AND MCI TELECOMMUNICATIONS CORPORATION

PETITION FOR REVIEW FROM THE UTAH PUBLIC SERVICE COMMISSION

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UTAH

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## **JURISDICTION AND NATURE OF PROCEEDINGS**

The Utah Supreme Court has jurisdiction over this appeal under Article VIII, Section 3 of the Utah Constitution; Utah Code Ann. §§ 63-46b-16(1) and 78-2-2(3)(e)(i); and Rule 14 of the Utah Rules of Appellate Procedure. This appeal seeks review of orders of the Public Service Commission issued in consolidated Docket Nos. 90-049-03 and 90-049-06.

## **STATEMENT OF THE ISSUES PRESENTED ON APPEAL AND THE STANDARDS OF APPELLATE REVIEW**

Respondents agree with USWC in its Statement of Issues and Standards of Review with the following exceptions:

Issue #1. The Court must not only determine whether the Commission erroneously interpreted the Stipulation, but must, in order to grant the relief requested by USWC, conclude that the Company's interpretation was the only possible one. In addition, the Court must decide whether the terms of the Stipulation itself preclude USWC's appeal.

Standard of Review. On its face, USWC's assertion that the Stipulation is a contract, the interpretation of which is a question of general law, appears reasonable. Respondents believe, however, that the crux of the issue is the meaning of the term "normalization," a utility accounting concept, in a settlement sanctioned by the Public Utility Code.<sup>1</sup>

Analogizing from Morton International Inc. v. Auditing Division,<sup>2</sup> Respondents believe that

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<sup>1</sup> USWC argues that "the term 'normalization' has a clear and explicit meaning that the Commission has utterly ignored." USWC Opening Brief at 30. § 54-7-1, Utah Code Ann., allows the Commission to approve settlements "after considering the interests of the public and other affected persons."

<sup>2</sup> 814 P.2d 581, 586 (Utah 1991). Morton International dealt with the interpretation of a statute, as opposed to a Stipulation.

the Commission "has special experience or expertise" in interpreting a utility term-of-art and that its interpretation should be given deference.

Issue #3. Respondents assert that the issue presented to the Court is whether the Commission properly interpreted and applied Utah Code Ann. § 54-3-1 (1990), § 54-4-7, § 54-4-8 (1990) and 54-8b-11 (1990), requiring USWC to upgrade the electromechanical central offices switches. USWC conceptualizes the issue too narrowly.

Standard of Review. The standard of review for this issue is reasonableness because the determination of what is in the public interest, or promotes the security or convenience of the public, is a matter peculiarly within the expertise of the Commission. The Commission is to be given deference "when there is a grant of discretion to the agency concerning the language in question either expressly made in the statute or implied from the statutory language." Morton Int'l v. Auditing Div., 814 P.2d 581, 598 (Utah 1991).<sup>3</sup>

Issue #5. The issue is whether the Commission is required to make a finding that each individual central office is economic, or is required to allow the utility to earn a reasonable return on its overall investment.

Issue #7. See response to #3 above.

Additional Issue: Should the Commission's findings be deemed conclusive because USWC failed to marshall the evidence? Boston First Nt. v. Salt Lake Cty. Bd., 799 P.2d 1163, 1165 (Utah 1990); Heinecke v. Dept. of Commerce, 810 P.2d 459, 464 (Utah App. 1991).

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<sup>3</sup> See also Luckau v. Board of Review, 198 Utah Adv. Rep. 30 (Utah App. 1992); King v. Industrial Commission, No. 920464-CA, slip op. (Utah App. March 18, 1993).

## **DETERMINATIVE CONSTITUTIONAL PROVISIONS STATUTES AND RULES**

The following statutes, which are set forth fully in Addendum 1 to this Brief are determinative of the issues in this case: Utah Code Ann. § 54-3-1 (1990), Utah Code Ann. § 54-4-1 (1990), Utah Code Ann. § 54-4-7, Utah Code Ann. § 54-4-8 (1990), Utah Code Ann. § 54-7-1 (1990), and Utah Code Ann. § 54-8b-11 (1990).

### **STATEMENT OF THE CASE**

Respondents agree with the USWC's Statement of the Case.

#### **I. THE STIPULATION ISSUES**<sup>4</sup>

##### **STATEMENT OF FACTS**<sup>5</sup>

A. Introduction. Respondents generally accept USWC's statement of facts. USWC's factual recitation is misleading, however, in that it:

1. Fails to mention that as actual figures for the test year became available, USWC was facing an ever increasing rate reduction, thus providing a motive for its attempt to add \$6 million to its revenue requirement.
2. Fails to mention that at the time the Stipulation was signed, USWC believed that the updates would result in no huge differences in the final results, while at the time 12

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<sup>4</sup> For continuity and ease of understanding, from this point forward, Respondents have divided their Responsive Brief into two general sections: I. The Stipulation Issues; and II. The Modernization Issues. Within each general section are the Statement of Facts, Summary of the Argument, and Argument which relate to that section.

<sup>5</sup> This addition to USWC's Statement of Facts has been included not because the Court must look to the extrinsic intent of the parties, but because USWC's factual recitation is incomplete and misleading.

months data were available, the Company was referring to the profound impact of its newly proposed adjustments.

3. Misleadingly states that the parties presumed from the beginning that the Commission's final order would be based on 12 months of actual data (thus permitting year-end adjustments discretionary with USWC), when in fact the expectation was that only 11 months of actual data would be available.

4. Fails to acknowledge that discovery on revenue requirement issues expressly terminated on November 26, 1990.

B. The Evolution of the Stipulation. The impetus to stipulate came from Commission Chairman Stewart in an August 1, 1990 law and motion hearing. R. at 355. In conformance with the Commission's directive, during August and September, 1990, the parties negotiated a stipulation on revenue requirement. USWC prepared the draft of the Stipulation which, with a few modifications, was eventually executed.<sup>6</sup> The Stipulation was filed with the Commission on November 7, 1990.<sup>7</sup>

Two days after the Stipulation was filed with the Commission, while arguing a motion to Amend the Hearing Schedule, Counsel for USWC described the magnitude of the changes expected from the updating of numbers contemplated by the Stipulation:

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<sup>6</sup> The rule in Utah is that an agreement should be construed against its drafter. Allstate Enterprises, Inc. v. Heriford, 772 P.2d 466 (Utah Ct. App. 1989); Wilburn v. Interstate Elec., 748 P.2d 582 (Utah Ct. App. 1988). Before a document is construed against its drafter, however, the trier must have found the contract ambiguous and been unable to interpret it with the aid of extrinsic evidence. Since the Commission never found the Stipulation ambiguous, and USWC is not arguing that the Stipulation is ambiguous, construing the Stipulation against USWC appears unnecessary.

<sup>7</sup> For the provisions of the stipulation relevant to this appeal, see Addendum 2.

Well, there will be some difference. As you update for actuals, the numbers will come out somewhat different. I guess we're not contemplating they're going to come out in huge--there aren't going to be any huge differences.

R. at 415 (emphasis added). At that time, USWC indicated that the Company expected a rate reduction of about \$6 million (in addition to the \$8 million interim decrease already ordered) assuming the rate of return, capital structure and depreciation rates remained unchanged. R. at 417.

On November 1, 1990, the Commission issued its Third Amended Scheduling Order, which provided that November 26, 1990 was the last day to ask discovery on issues relating to revenue requirement. R. at 4558.<sup>8</sup>

On December 17, 1990, the Commission convened a hearing for the presentation of evidence supporting the Stipulation. The previous Friday (December 14), the Division of Public Utilities ("Division") had filed a version of JE-1 updated for 9 months of actual data. During the hearings, Mr. Henningsen, the Division's accounting witness, after explaining some minor corrections to pages 3 and 4 of JE-1, added:

(Mr. Henningsen): I might also add that after we discovered this, just this afternoon [i.e. December 17], USWC told us that they think there's another problem in the tax, the fuel taxes that they provided us in the FR 1990's that are the basis for the actuals of the first nine months.

The error that they think they found would have about offset the error that we found this morning the other way....

R. at 463-5. Later that afternoon, Ms. Kyritz, USWC's accounting witness, described the problem further:

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<sup>8</sup> This deadline was confirmed in the Commission's Fourth Amended Scheduling Order, issued on November 23, 1990. R. at 4624.

Mr. Smith (to Ms. Kyritz): I wonder if you could take a moment and give a little more detailed explanation of the concern that you have and what you attribute it to, at least at this point?

Ms. Kyritz: Yes. Mr. Henningsen said that when we pointed out there is a problem with the taxes and we are talking income taxes, both state and federal, on the results that are shown in the joint exhibit as of September, that it was because of allocations. It's not a problem with allocations. It's a problem with the actual number, the percentage used to calculate the taxes for the State of Utah.

There was a change made and apparently was keyed wrong and, therefore, the number is incorrect.

R. at 513 (emphasis added). When counsel for USWC asked Ms. Kyritz when USWC's investigation of this "problem" would be completed, Ms. Kyritz stated: "We are investigating and we think we have it resolved and I hope to have the numbers for the new exhibit tomorrow [i.e., December 18, 1990, emphasis added]." R. at 514. Nothing was filed with the Commission, however, until the following April.

Another exhibit presented in the December hearing showed the amount of the expected rate reduction based on 9 months of actual data (R. at 6590; see also R. at 460). Whereas the expected rate reduction based on 6 months of data had been about \$6 million, the amount of the expected reduction with 9 months of actual data was now about \$11 million.<sup>9</sup> When twelve months of data were available, the expected reduction had risen to over \$21 million.<sup>10</sup>

On January 3, 1991, two weeks after the December 17th hearing, the Commission issued an order approving and adopting the Stipulation, finding that it was "based on factual analysis by the parties, and that the public interest will be served by its approval." R. at 4654.

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<sup>9</sup> Exhibit DPU 1.6, line 10 (Net Over Earnings at 11.80%). R. at 6590.

<sup>10</sup> See the Division's Net Excess Revenue for 11.8% return on equity (the previously ordered Company ROE), dated April 19, 1992. R. at 5242.

C. The Unraveling of the Stipulation.

The next reference in the record to the Stipulation is not until April 5, 1991, three months after the Commission's order approving it. During the interim, hearings proceeded on the three unresolved revenue requirement issues.<sup>11</sup> On March 21, 1991, USWC provided the Division full 1990 financial results unadjusted for regulatory purposes. R. at 5121. On April 5, 1991, the Division filed an updated JE-1 with 12 months of actual data. R. at 5109-15.<sup>12</sup> The JE-1 filed with 12 months of actual data differed substantially from the JE-1 with 9 months of actual data which had been approved by the Commission on January 3, 1991.<sup>13</sup> In response to a Committee Motion to Suspend a

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<sup>11</sup> These are not the same three issues eventually raised by U S West, but the three issues which the Stipulation reserved for hearings: rate of return, capital structure and depreciation represetion. R. at 4569.

<sup>12</sup> Despite U S West's contention in its brief that the parties always contemplated JE-1 being updated for 12 months of actual data (U S West Opening Brief at 12, 15, 30 (twice), 34, 36, 37 (twice) and 38), the record confirms that it was the protracted hearing schedule which ultimately resulted in 12 months of actual data being available. This is important because a substantial part of the contested \$6 million constitutes what is known in utility accounting as "year-end adjustments," i.e. adjustments to the books at the end of the accounting year which may or may not be discretionary with the Company. (See also R. at 3515)

<sup>13</sup> For example, the following "hard" columns (i.e., columns that the parties agreed would not be updated) were changed: (2) Prior Period SNFA; (5) Prior Period Ind Co Settlements; (6) Annualize 5 + 5 Savings; (8) Annualize Univ. Serv. Fund; (c) PAC & Shareholder; (j) Ext. Rel. Advertising; (q) Interim Rate Reduction. The update of the Interim Rate Reduction in the amended JE-1 was because the parties agreed they had made a mistake in the original JE-1. The Company stated (Mr. Smith): "...I have been authorized by the Company to indicate to you that we are willing to have that column updated and I think I would be safe in saying that its inclusion in paragraph 7, I don't know whether you would call it a mistake, whatever, the Company is willing to have that updated." R. at 3543. In addition, during oral arguments on its Petition for Rehearing on July 31, 1991, Mr. Smith affirmed, "We are not arguing that the interim rate column should not have been updated. We did indeed agree that the Commission could update that." R. at 3639. See also R. at 463.

Of greater significance, the following columns, which had never been included in either the JE-1 with 6 months or 9 months of actual data, were added: (4) Anti-trust inside wire settlement; (u) Prior period lifeline; (AC) 1989 Tax True-up; (AD) Tax Correction; (AE)



proposed hearing on JE-1, counsel for USWC, referring to the Company's three new proposed adjustments,<sup>14</sup> stated:

The adjustments that need to be made to the actual results in order to normalize them are highly important and have a profound<sup>15</sup> impact on the revenue requirement.

R. at 5122, emphasis added.

The Commission ordered the parties to file written statements setting forth their positions on the disputed adjustments on April 19 and April 26, 1991:

The Division's Position: The Division stated that one of the reasons it entered into the Stipulation "was to end the opportunity for any party to raise new adjustments." The Division acknowledged that although it had reviewed each month's "actuals", it had "not performed any further detailed analysis of the data." R. at 5228, 7167. The Division concluded that since normalization adjustments were contemplated by the Stipulation, and the three new adjustments proposed by USWC were normalization adjustments, the proposed adjustments

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Prior period depreciation. The first of these, the anti-trust inside wire settlement, was presumably added because U S West had entered into an agreement to settle a class-action lawsuit in the New Mexico Federal District Court in which it agreed that none of the costs of the suit would be included in rates. Thus, U S West had presumably to either exclude that amount from rates or be in violation of a federal court order. R. at 3581-2. The other three adjustments constitute the \$6 million in disputed adjustments.

<sup>14</sup> Although the new adjustments proposed by U S West fell into three general categories, each adjustment was made up of numerous items. For example, the tax true-up consisted of sixteen different adjustments; and the tax correction adjustment consisted of six different adjustments. R. at 5252. With discovery on revenue requirement issues having ended on November 26, 1990, the Company's sole access to its accounting records became a critical inequity.

<sup>15</sup> Compare this with the Company's statement at the time the Stipulation was presented for Commission approval that "there aren't going to be any huge differences." R. at 415.

should be analyzed in terms of traditional rate-making concepts.<sup>16</sup> On that basis,<sup>17</sup> the Division recommended that all but \$2.1 of the \$6 million be disallowed. The Division acknowledged that, "Had the discovery process continued, there could very well have been other known and measurable out-of-period adjustments proposed by the parties to the case." R. at 5311.

The Company's Position: USWC argued that its new proposed adjustments were "totally consistent with others made in JE-1 and with Commission action in prior cases," construing the Stipulation as allowing each month's new "actuals," as well as any year-end accounting adjustments, even if discretionary, to be annualized and normalized. R. at 5246, 5248.<sup>18</sup> The Company did not specifically address the restrictive language that new actuals were to be annualized and normalized "consistent with the annualization and normalization of six months actual data in JE-1" (emphasis added); nor did it address how the language of Paragraph 6 that "several of the Columns in JE-1 shall be updated with monthly actual data" could be harmonized with the fact that the three new adjustments would require the addition of new columns. The essence of the Company's argument was that normalization adjustments of the kind proposed had been allowed by the Commission in past cases and were generally

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<sup>16</sup> The Division also recommended disallowing part of the tax correction adjustment because U S West had known about it when the Stipulation was signed but not included it. R. at 5234.

<sup>17</sup> And on the basis of an additional normalization adjustment proposed by the Division that had not been in the original stipulation--Column (u), Prior Period Lifeline. R. at 5112.

<sup>18</sup> One of U S West's proposed adjustments, the manner in which the Company booked the amortization of non-protected deferred taxes terminating in 1991, is an example of a discretionary booking.

allowed by Commissions throughout the country and that it would be unfair not to allow them now. R. at 5248-51, 5270-1<sup>19</sup>.

The Committee's Position: The Committee argued that "the Stipulation is what the parties negotiated and bargained for and executed," and that the "Commission's options were either to accept it or reject it." R. at 5224, 5330. Therefore, arguments on the merits of any newly added normalization adjustment under typical ratemaking principles were irrelevant. R. at 5333. The Committee reminded the Commission that the parties had each negotiated away adjustments they would have advocated in a fully litigated proceeding. R. at 5331. The Committee also suggested that the Company's introduction of new and disputed adjustments resulted from the fact that the "rate reductions under the Stipulation are larger than USWC originally anticipated." R. at 5224. The Committee interpreted the Stipulation's language that "several of the columns in JE-1 shall be updated with monthly actual data" as meaning that the "hard" numbers were to remain "hard,"<sup>20</sup> and as clearly implying that "new" columns could not be added.<sup>21</sup>

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<sup>19</sup> USWC has also argued the same in its Opening Brief. See Opening Brief at 26: "Normalization adjustments have routinely been approved by the Utah Public Service Commission in past orders." See also U S West's Opening Brief at 30-4, 38.

<sup>20</sup> When the Committee became aware that one "hard" column (i.e., SNFA, a column which the parties agreed would not be updated) which had been updated resulted in a \$1.7 million adjustment in the ratepayer's favor, the Committee took the position that the "hard" number had to be reinstated even though this benefitted the Company. R. at 5332.

<sup>21</sup> The Committee contended that such a conclusion was reinforced by considering the absurd result of adopting the Company's interpretation that new columns could be added for any new normalization or annualization adjustment a party could discover when the Company had sole access to the relevant data. The Company argued at one point that there was no discovery deadline (R. at 3512) in spite of the Commission's Third and Fourth Revised Scheduling Orders and in spite of its response to a Committee data request, filed in January, 1991, inquiring into Charitable Contributions (a column that was clearly subject to updating).

After filing its two position statements, USWC petitioned to argue orally before the Commission and asked that the position statements be received as evidence, which petition the Commission granted. R. at 5337-9, 5344-5.

In the May 15, 1991 oral arguments (R. at 3497-3588), the parties reiterated the positions outlined in their two prior submissions with respect to the disputed \$5.916 million.<sup>22</sup> The Committee reiterated its position that the Stipulation was unambiguous, that the types of adjustments being proposed by the Company were not contemplated by the parties, and that the Commission must either strictly apply it or convene full hearings on revenue requirement. R. at 3579.

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R. at 4573, 4582. To the Committee's Data Request, U S West responded:

The premise of the question is that it is an attempt to verify whether lobbying expenses have been booked below-the-line. This is obviously an issue that relates to revenue requirement. On October 30, 1990, the Company Division and Committee filed a Stipulation and Joint Motion on Revenue Requirement issues. Per that Stipulation, the only outstanding issues were rate of return, capital structure, depreciation represetation and the correct calculation of current PRB expenses. That Stipulation was approved by the Commission on January 3, 1991. Thus, with the exception of the limited issues set forth above, the revenue requirement issues relating to 1990 have been fully resolved. 1989 is totally irrelevant to this case. Therefore, USWC objects to this data request on the ground that it is not calculated to lead to the discovery of relevant evidence in this case.

Notwithstanding the foregoing objection, USWC will respond for 1990. Nothing of the nature described in the data request was included for ratemaking purpose [sic] in 1990.

R. at 5327.

U S West was correct that data for 1989 were irrelevant to the case then being considered. The objection to providing the 1990 data, however, clearly demonstrates the Company's understanding as to whether the Division and Committee were entitled to engage in further discovery on revenue requirement issues after the Stipulation was signed.

<sup>22</sup> A breakdown of the \$5.916 million is provided in "Summary of Positions on Disputed Adjustments (Revenue Requirement Impact). R. at 8379.

The Commission issued its Report and Order on June 19, 1991. As to the Stipulation, the Commission found that the intent of the parties to exclude consideration of further adjustments than those specified in JE-1 was clear from paragraphs six and seven. R. at 5389. The Commission also found that the Stipulation was a negotiated document which entailed compromises on all sides that had been understood by the parties when it was presented for approval in December, 1990, with 9 months of actual data. R. at 5391. The Commission concluded that its understanding of the meaning of the Stipulation was controlling<sup>23</sup> and that: "None of the adjustments now argued for by USWC or the Division were considered open issues by the Commission." Addendum 3, p. 12; R. at 5391. The Commission further concluded that the adjustments proposed by the Company and the Division "are not permitted by the terms of the Stipulation and are therefore rejected."<sup>24</sup>

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<sup>23</sup> At page 39 of its Opening Brief, U S West criticizes the Commission for presenting "a novel theory of contractual interpretation: regardless of the literal language of the Stipulation, the determinant of its meaning is what the Commission subjectively understood." The Company proceeds to cite contract law that a court "is to give effect to the intentions of the parties" and concludes that "the subjective intent of the court (or Commission) is utterly irrelevant...."

The problem with U S West's analysis is that it assumes the Commission, in its quasi-judicial role of interpreting the contract, is acting precisely the same as a court. In reality, however, the Commission is not acting only as a decision-maker between opposing parties, but is also required to decide whether the agreement is in the public interest. In making that finding, the Commission in a sense becomes a party to the agreement and its "subjective" understanding of the meaning of the agreement becomes relevant. See Utah Code Ann. § 54-7-1 (1990).

<sup>24</sup> The Commission never concluded that the Stipulation was ambiguous. A few days after issuing its Report and Order, the Commission issued "Attachment A. Supplement to June 19, 1991 Order," which included the Commission's JE-1 spreadsheet upon which its revenue requirement was based. The spreadsheet retained the "hard" columns from the JE-1 with nine months of actual data, updated the "soft" columns to year-end levels, and removed the additional columns proposed by the Company and Division. R. at 5548-5553.

On July 19, 1991, USWC filed a Petition for Reconsideration in which it disputed the Commission's interpretation of the Stipulation. R. at 5814-5623. Citing the language of paragraphs 5, 6 and 9 of the Stipulation, the Company concluded "that the Stipulation explicitly contemplated that the updated results for the last six months of the year would be subject to annualization and normalization adjustments."<sup>25</sup> The Company referred to Division witness Henningsen's testimony in December, 1990 that there may be a problem with the tax numbers, but did not mention that the error alleged at that time was a number which had been "keyed wrong" and which would be corrected in the next few days. R. at 514. In addition to the arguments made previously, the Company labeled as "arbitrary and capricious" the Commission's updating of the Interim Rate Reduction (Column Q), even though it had explicitly agreed to such an update. R. at 5680, 5622. The Commission set oral hearings on the Petition for Rehearing for July 31, 1991.

During the July 31, 1991 arguments on USWC's Petition for Rehearing, the Company argued that even though some columns were to be updated and others not, nothing in the

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<sup>25</sup> R. at 5616. In its citation of paragraph 6 of the Stipulation, the Company underlined the words annualization and normalization, but left the phrase "consistent with" unemphasized:

...on an annualized and normalized basis consistent with the annualization and normalization of six months actual data in JE-1.

Id.

The only place on the record that U S West may be considered to have responded to the "consistent with" language is in its arguments on rehearing:

Mr. Smith: ...It's our contention that those adjustments are clearly normalization adjustments, that they are either identical or similar to other adjustments made to the first six months data or which have traditionally been made in past rate cases.

R. at 3608, emphasis added. As argued more fully below, Respondents believe there is a world of difference between adjustments "similar to the normalizations in the initial JE-1" and normalizations "consistent with the...normalization of six months actual data in JE-1."

Stipulation precluded additional adjustments (columns) and that this misinterpretation "is the fundamental error that we believe has taken place." R. at 3610-11.<sup>26</sup> The Committee, noting that the timing of some bookings (adjustments) is discretionary with USWC, argued that it never would have signed a stipulation which called for a termination of discovery and did not limit the Company's ability to search out additional self-serving adjustments.<sup>27</sup> R. at 3626-7. The Committee reiterated its intent to be strictly bound by the explicit terms of the Stipulation.<sup>28</sup>

The Division expressed its understanding that after signing the Stipulation, the parties would not be

looking for new adjustments, but that the actual results each month were reviewed to look for normalization adjustments. No new adjustment were looked for. But the stipulation, I think, did leave the confusion as to what would happen when in the actual results of operation an item occurs that required normalization.

The stipulation would then require you to normalize that item by creating a new column.

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<sup>26</sup> Commissioner Byrne asked if there was any significance to the blank columns in the original stipulation, 12, 13, X, Y and Z. All parties indicated that the blank columns were a function of the spreadsheet software and that no implications should be drawn from their presence. R. at 3612-3.

<sup>27</sup> Mr. Smith, in his opening brief correctly stated that "there are literally hundred of potential revenue requirement issues that parties can raise." U S West Opening Brief at 9.

<sup>28</sup> Walgren (for Committee): We were parties who were dealing at arms length and when we signed that, it was our consideration that that was the agreement.

If it turned out that we shouldn't have done -- in fact, we were very reluctant to do it and nearly didn't sign it because of past problems with the Company. We knew that if it ended up against our interests in the end, we would have to eat it. If the Committee had come to me and had been aware of some adjustments such as the Company here has proposed that went in our favor six million dollars and it said, I want you to file a motion with the Commission asking them to amend the stipulation to include those or interpret it in such a way that those would be included, I would have told them that I couldn't do that in good faith, based on my understanding of what we had agreed to. R. at 3627.

On August 13, 1991, the Commission issued its Order on Review, concluding:

The Committee's view of the Stipulation is the one the Commission finds most reasonable and which most closely resembles the plain meaning of the Stipulation as a whole. By forbidding updated information to be inserted into certain of the defined categories of Exhibit JE-1...and by limiting it to the others, paragraphs six and seven, the Stipulation provides definition, certainty and finality, which permits the parties to devote limited resources to more pressing issues. To allow the addition of new categories, as the Company suggests, makes the Stipulation vulnerable to endless debate and discovery, the very problems that stipulations are intended to avoid.

Addendum 4, pp. 3-4; R. at 5697-8.

### **SUMMARY OF ARGUMENT--STIPULATION ISSUES**

1. USWC is precluded from seeking judicial review of the Stipulation by the express language of the Stipulation itself.
2. USWC having failed to withdraw from the Stipulation and proceed with a full hearing on revenue requirement, the Commission's interpretation is binding. USWC's requested relief, that the case be remanded to the Commission for consideration of only the Company's adjustments, should not be granted because the Company's interpretation is not the only possible reasonable one.
3. The language of the Stipulation is unambiguous, and the Commission's interpretation is reasonable. USWC has never suggested that the Stipulation is ambiguous. only that the Company's interpretation is the only possible reasonable one. A plain reading of

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<sup>29</sup> On the merits, the Division continued to assert that the \$5.9 million should be reduced to \$2.1 million.



the Stipulation, with an eye toward harmonizing all of its provisions, substantiates the Commission's interpretation.<sup>30</sup>

### **ARGUMENT--STIPULATION ISSUES**

#### **I. BY THE EXPRESS TERMS OF THE STIPULATION, USWC IS BARRED FROM SEEKING JUDICIAL REVIEW.**

Utah Code Ann. § 54-7-1 permits settlement conferences among parties and authorizes the Commission to adopt settlements in the public interest. The Commission found the parties' Stipulation, with attached JE-1 having nine months actual data, in the public interest and adopted it. Paragraph 13 of the Stipulation states:

13. Review/Rehearing and Appeal. Nothing in this Stipulation shall bar or be deemed to bar any party from seeking review and rehearing or judicial review of any aspect of the Commission's final order in these consolidated proceedings except with respect to matter expressly agreed to in this Stipulation.

R. at 4577, emphasis added.

It is clear that in executing the Stipulation the parties waived any right to appeal on revenue requirement issues.<sup>31</sup> This Court should, therefore, dismiss USWC's appeal as it relates to the Stipulation on the revenue requirement issues.

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<sup>30</sup> The Division, which took the position before the Commission that the Company's new adjustments should be considered on their merits, does not join in this section of the Brief. The Division does, however, agree with the first two Stipulation arguments. MCI does not participate in the Stipulation section of the brief.

<sup>31</sup> This Court has held that if parties waive their right to appeal, such an agreement should be binding on the parties. C.G. Horman Co. v. Lloyd, 499 P.2d 124, 125 (Utah 1972) and cases cited in note 4. U S West may argue that since neither the Division nor the Committee raised this issue in the rehearing proceedings before the Commission, they are foreclosed from raising it now before this Court. To such an argument, Respondents answer: (1) The Stipulation prohibits the parties seeking review, rehearing, and judicial review; thus, Appellant had to first seek judicial review before the clause prohibiting it became relevant. (2) Since Respondents did not appeal, there was no duty on their part to perfect the appeal by first petitioning for rehearing.

**II. BY THE EXPRESS TERMS OF THE STIPULATION, OR WITH THE COMMISSION'S CONSENT, USWC COULD HAVE WITHDRAWN FROM THE STIPULATION; USWC HAVING FAILED TO WITHDRAW, THE COMMISSION'S INTERPRETATION IS BINDING.**

The Commission never found, nor has USWC argued before the Commission or before this Court, that the Stipulation is ambiguous, thus requiring any reference to the extrinsic intent of the parties. Neither has USWC ever indicated a desire to withdraw from the Stipulation and proceed to a full hearing on revenue requirement. Instead, USWC has insisted on its interpretation of the Stipulation, an interpretation which demands consideration of adjustments which could increase Company revenues and prohibits consideration of adjustments which could decrease company revenues.<sup>32</sup>

Paragraph 12 of the Stipulation provides in part:

The Stipulation is an integrated agreement, the provisions of which are dependent upon each other. Therefore, if it is not accepted in its entirety, the parties are free to withdraw therefrom.

R. at 4577. USWC could have claimed that the Commission's interpretation of the Stipulation was a failure to accept it in its entirety and withdrawn from it. Even though it is arguable whether paragraph 12 grants USWC the absolute right to withdraw under these circumstances,

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<sup>32</sup> USWC argues in its Opening Brief that "The right to propose normalization adjustments was not a one-way street--all parties had the right to propose normalization adjustments to the last six month's financial results." When one comprehends, however, that discovery had ended November 26, 1990 (with only eight months of actual data), and when one takes into account U S West's reaction to the Committee's Data Request on Charitable Contributions, a "soft" column in JE-1, the Company's argument is seen for the chimaera that it is.

the record is clear that the Commission gave the Company every opportunity to withdraw, but the Company refused.<sup>33</sup>

USWC having failed to exercise its option to withdraw from the Stipulation and proceed with full hearings on revenue requirement, it now stands before this Court asking for an astonishing remedy: that the Court remand this case to the Commission with instructions to consider only the merits of the new adjustments proposed by the Company. It is vital to remember that this is the sole relief the Company is requesting in this appeal.<sup>34</sup> Respondents believe that the Company had two choices: withdraw from the Stipulation and proceed with full revenue requirement hearings; or be bound by the Stipulation as interpreted by the Commission. Unless this Court concludes that the interpretation of the Stipulation asserted by USWC is the only possible reasonable one, the Commission's decision must be upheld.

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<sup>33</sup> During the May 15, 1991 oral arguments, long after the Stipulation had been adopted by the Commission, Commissioner Byrne began by asking whether or not there was still a Stipulation:

...I'm not sure what sense it makes to argue adjustments to a stipulation that's no longer being recommended by the parties.

R. at 3502-03.

Counsel for U S West voiced the Company's position "very strongly" that "we definitely have a stipulation" and that it was not withdrawing from it. R. at 3503-4.

Chairman Stewart also asked the Committee at that time if the Committee was abandoning the Stipulation. R. at 3506. See also R. at 3575.

<sup>34</sup> See U S West's Opening Brief at 40:

USWC therefore requests that this Court reverse the Commission's refusal to consider the normalization adjustments proposed by USWC, remand the matter to the Commission with the direction to consider those adjustments, and to require that, to the extent the adjustments are accepted, USWC be allowed to recover from ratepayers the revenues it should have received had the Commission correctly interpreted and applied the Stipulation (emphasis added).

### III. THE LANGUAGE OF THE STIPULATION IS UNAMBIGUOUS AND THE COMMISSION'S INTERPRETATION IS REASONABLE AND SHOULD BE UPHELD.

The law is well-established that before inquiring into extrinsic evidence, the trier of law must first conclude that the agreement is ambiguous.<sup>35</sup> It is equally well established that "the mere fact that the parties urge diverse definitions of contract terminology does not, per se, render it ambiguous."<sup>36</sup>

In interpreting a contract, "the intentions of the parties are controlling."<sup>37</sup> The trier of law must attempt to glean the underlying intent "from the language of the instrument itself."<sup>38</sup> In addition, this Court has held that, "It is axiomatic that a contract should be interpreted so as to harmonize all of its provisions."<sup>39</sup>

The relevant provisions of the Stipulation which the Commission set about to "harmonize" are:

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<sup>35</sup> Winegar v. Froerer Corp., 813 P.2d 104, 108 (Utah 1991); Fitzgerald v. Corbett, 793 P.2d 356, 360-61 (Utah 1990); West Valley City v. Majestic Inv. Co., 818 P.2d 1311, 1313 (Utah Ct. App. 1991).

<sup>36</sup> Id.; see also, Land v. Land, 605 P.2d 1248, 1251 (Utah 1980); Buehner Block Co. v. UWC Assocs., 752 P.2d 892, 895 (Utah 1988); Camp v. Deseret Mut. Benefit Ass'n, 589 P.2d 780, 782 (Utah 1979).

<sup>37</sup> Winegar, 813 P.2d at 108.

<sup>38</sup> Land, 605 P.2d at 1251.

<sup>39</sup> Jones v. Hinkle, 611 P.2d 733, 735 (Utah 1980). In a later case, the Court was more specific:

The primary rule in interpreting a contract is to determine what the parties intended by looking at the entire contract and all of its parts in relation to each other, giving an objective and reasonable construction to the contract as a whole.

Sears v. Riemersma, 655 P.2d 1105, 1107-08 (Utah 1982).

1. That "the parties have resolved all issues relating to the calculation of revenue requirement..." R. at 4569. Similarly, "The purpose of this Stipulation is to settle in their entirety, all revenue requirement issues...." R. at 4577<sup>40</sup>

2. That JE-1 "sets forth the adjustments that the parties have agreed to and which the Commission should incorporate into its final revenue calculation. For illustrative purposes, the parties have calculated JE-1 using six months actual results which have been annualized and normalized...The final calculation of revenue requirement will use updated results, as described below.... R. at 4571.

3. That "the parties agree that several of the columns in JE-1 shall be updated monthly with additional actual data. At the time of the December hearings, the parties will provide the latest updated JE-1 which will present nine months actual results on an annualized and normalized basis consistent with the annualization and normalization of six month's actual data in JE-1. The method of calculation shall be the same as in Exhibit JE-1. Subsequent monthly updates will be provided to the Commission." R. at 4573.

4. That all columns on JE-1 shall be updated, with the exception of Columns 2-11, B,C,I,J,M-Q,S-V.<sup>41</sup> R. at 4573-4.

The Commission's Interpretation:<sup>42</sup> The columns in JE-1 (except Column 1, the raw Company data) generally quantify the following adjustments to raw company data: annualizations and normalizations of company revenues and expenses, allowances or disallowances, and calculations. The core of the conflict is whether the Stipulation allows new normalizations--which necessitates adding additional columns--or limits normalization

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<sup>40</sup> USWC states in its Opening Brief at p. 27 that the Commission's Order "failed to take into account the nature and purpose of the Stipulation, which was to create a representative test period for rate-setting purposes." (emphasis added; see also U S West Opening Brief at 38). Yet nowhere in the Stipulation do the parties state that mimicking a representative test period is the purpose of the stipulation. According to the explicit terms of the Stipulation itself, its purpose is "to settle in their entirety, all revenue requirement issues..." R. at 4577. USWC is silent about how that stated purpose is in accord with its demand that the Commission consider its new adjustments.

<sup>41</sup> Another way of saying this is that Columns 1, 14, 15, A, D-H, K-L, R, W, AA, BB and CC will be updated and the others will not be updated.

<sup>42</sup> The Commission adopted the Committee's interpretation.

adjustments to the columns which the parties specified would be updated.<sup>43</sup> The Commission concluded that taking "the Stipulation as a whole," the language "forbidding updated information" of some columns and "limiting it to others" provides "definition, certainty and finality," and permits the parties to devote limited resources "to more pressing issues." The "addition of new categories" would make the Stipulation "vulnerable to endless debate and discovery." Addendum 3, p. 4; R. at 5698. See also R. at 5391. Thus, the Commission was able to harmonize all of the relevant provisions of the Stipulation set forth above: the language on comprehensiveness,<sup>44</sup> the language on annualization and normalization,<sup>45</sup> and the explicit enumeration of which columns could be updated.

The Company's Interpretation: The company's interpretation is illogical in three ways: (1) It does not account for why the parties would go to the trouble to restrict updates to some columns while leaving open the possibility of adding innumerable additional columns;<sup>46</sup> (2)

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<sup>43</sup> An example of a normalization column subject to update is Column (H), Uncollectibles.

<sup>44</sup> "The parties have resolved all issues relating to the calculation of revenue requirement," and "The purpose of this Stipulation is to settle in their entirety, all revenue requirement issues."

<sup>45</sup> Although the Commission did not specifically address the meaning of the phrase "consistent with" ("the parties will provide the latest updated JE-1 which will present nine months actual results on an annualized and normalized basis consistent with the annualization and normalization of six month's actual data..."), the conclusion that, "the language restricting updates to certain columns" indicated an intent to prohibit additional columns makes it clear that "consistent with" did not mean, as the Company argued, "similar to." R. at 3608.

<sup>46</sup> Mr. Smith correctly stated in his Opening Brief at 9 that in a typical rate case "there are literally hundreds of potential revenue requirement issues that parties can raise."

It requires interpreting the phrase "consistent with" so broadly as to mean "similar to"<sup>47</sup>; (3) It is inconsistent with the expressed intention of the parties to resolve and settle all issues relating to revenue requirement in their entirety.

Respondents contend that a plain and objective reading of the Stipulation by a reasonable person attempting to harmonize all of its provisions necessarily leads to the same conclusion that the Commission reached: that the Committee's interpretation was the only reasonable one; that the intent of the parties could be discerned from the language of the instrument itself, without resort to extrinsic evidence; and that all relevant parts of the agreement could be harmonized.

## **II. THE MODERNIZATION ISSUES**

### **STATEMENT OF FACTS**

A. Introduction. USWC's Statement of Facts on the modernization issues provides an incomplete history of the facts presented before the Public Service Commission supporting a modern telecommunication system in rural Utah. In particular, the company's Statement of Facts:

(1) Fails to provide evidence presented by company witnesses in support of modernization and the significant showing for the need for a modern

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<sup>47</sup> Webster's New Collegiate Dictionary defines "consistent" as "free from irregularity, variation, or contradiction." Similar, however, is defined much more broadly: "having characteristics in common" or "alike in substance or essentials." In order to argue its interpretation of the Stipulation, the Company had to define "consistent with" so loosely that it lost its customary meaning. In Utah, the words of a contract are to be given their ordinary and usual meaning. Pugh v. Stockdale & Co., 570 P.2d 1027, 1029 (Utah 1977).

USWC side-stepped this problem before the Commission and continues to do so in its Opening Brief. See USWC Opening Brief at 11, 12 and 30, where the Company conveniently emphasizes [i.e. underlines] "on an annualized and normalized basis" and "annualization and normalization of six months actual data in JE-1" but treats "consistent with" as if it were not there.

telecommunications system presented by political, community, educational, and business leaders throughout the state:

(2) Gives only a selective representation of the new services which would be available with a modern telecommunications system, leaving the Court with the impression that the only additional service would be custom calling features;<sup>48</sup>

(3) Ignores the record evidence showing that a modern telecommunication system is vital to the economic development of rural Utah and to the attractiveness of the state generally;

(4) Presents an extremely narrow perspective of the economics revolving around the modernization issues. (Appellant's Brief, pp. 19-23) USWC focuses on its late-filed CUCRIT study purporting to show that some of the central offices would not be profitable to USWC if converted. However, USWC fails to present the history surrounding its economic study and, more importantly, fails to inform the Court that the Company will be permitted to earn its authorized rate of return on its overall investment even though some individual central offices may not be profitable. In addition, USWC fails to provide the Court with the Commission's findings relating to USWC's authorized rate of return and depreciation rates.

The relevant facts which Appellant failed to adequately provide the Court are described more fully below.

B. The History of the Modernization Issues. On March 2, 1990, USWC filed its application for an incentive plan. That incentive plan would have permitted USWC to earn above its authorized rate of return, sharing profits between ratepayers and shareholders. In exchange for this incentive plan, USWC agreed to convert obsolete central offices to digital technology and install a modern fiber optics backbone network. USWC's Application (Addendum 5) provides an outline of the evidence USWC presented in this proceeding to

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<sup>48</sup> Throughout its brief, Appellant failed to acknowledge the significant new services that would be made available with digital central offices. Instead, USWC emphasizes only certain custom calling services such as call waiting. (See, for example, Appellant's Brief, p. 18, 51-53.) In particular, on p. 52 of its Opening Brief, USWC indicates that there are two major services cited by proponents of central office upgrades: custom calling and equal access.



support the modernization proposal. This evidence shows the significant benefits to both rural communities and to the state generally resulting from a modern telecommunications system in Utah.

To encourage support for its incentive plan, USWC promoted the need for modernization, orchestrating the submission of numerous letters in support of the upgrades from diverse governmental, business, and educational associations throughout the state.<sup>49</sup> Among these were letters from: 1) State representatives from nine districts; 2) State senators from five districts; 3) The county commissions of Sevier, Duchesne, Cache, Piute, Iron, Summit, and Washington counties; 4) Mayors from Bicknell, Corinne, Eureka, St. George, Parowan, Panguitch, Mt. Pleasant, Blanding, Midway, Morgan, Enterprise, Circleville, Brigham City, Logan, Richfield, Richmond, Helper, Kanab, Roosevelt, East Carbon, Garden City, Minersville, Price, Lehi, Vernal, Beaver, Coalville, and Smithfield City; 5) The Chambers of Commerce of Beaver, St. George, Ogden, and Vernal; 6) Twenty letters from educators located throughout Utah, including: St. George, Salt Lake, Logan, Ogden, Provo, Morgan, among others; 7) Thirty-six businesses and community leaders, including hospitals, banks, airlines, cable t.v. companies, as well as the Utah League of Cities and Towns, Cedar City Corporation Industrial Development, Utah Small Cities, Utah Business Development, and the Utah Center of Excellence.

In general, these letters requested that the Commission approve USWC's proposal for modernization and incentive regulation because of the importance to economic development

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<sup>49</sup> The letters to the Commission are scattered throughout the record. R. at 3807-08, 3812-18, 3836-39, 3847-53, 3855-61, 3890-91, 3907-08, 3916-17, 3928-33, 4142-43, 4145-46, 4149, 4152-55, 4160-63, 4166, 4168-86, 4234-40, 4267, 4318-19, 4545, 4607-20, 4622-23, 4633, 4639-40, 4647-51, 4660, 4917, 5010, 5066-67, 5078-82, 5094-96, 5107-08, 5349-67.

provided by a modern telecommunications network. The letters from educators focused on the importance to education of distance learning facilities.<sup>50</sup>

In its Opening Brief (p. 51), USWC points out that in the last general rate case<sup>51</sup> the Commission rejected a request by the Division that USWC be required to upgrade its electromechanical switches more rapidly. In addition, USWC points out (Appellant's Brief, p. 51, n. 37) that the Committee opposed upgrading USWC's electromechanical switches in the last rate case. It is ironic that in mobilizing community leaders, and by its own testimony in this docket, USWC convinced both the Commission and the Committee that conversion of the existing electromechanical offices to digital switches was essential to this state.

C. Quality of Service from Electromechanical Switches and the New Services Made Available from Digital Switches. USWC does not dispute that electromechanical offices would provide quality of service benefits to both residential and business customers in rural

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<sup>50</sup> Some of the comments received in the letters include: "If my constituents are ever to be able to compete with other areas on business recruitment, these improvements in communications capability are not just desirable, but absolutely vital. It is not just a matter of rate structures and organization; it is a matter of equity and simple decency." R. at 3812. "No matter what else we do, if we cannot offer business and industry the latest developments in communications technology we have almost no chance to compete. Businesses may already have a tendency to regard themselves as isolated in rural areas; if they cannot plug into the modern net [sic, i.e. network], the tendency may turn into a rock hard aversion to rural areas." R. at 3808. "In an ever-changing competitive world we feel that communications via fiber optics will be an essential link to our very survival. It is exciting to visualize the educational and learning options that will be opened through an expanded telephone network." R. at 3859. "We in Southern Utah would like to have the same opportunities and be able to compete in the markets necessary for growth. . . [W]e care about our community and want to support those things that would benefit it. Our children are our future community and we see the tremendous educational benefits that can be provided by this proposal, such as long distance learning, expanded curricula and in-service training for our teachers." R. at 3857.

<sup>51</sup> Docket No. 88-049-07 (Utah PSC. Report and Order issued October 18, 1989)

exchanges (Appellant's Brief, pp. 18-19);<sup>52</sup> however, USWC's Statement of Facts fails to describe the impact the lower quality of service would have on rural customers.<sup>53</sup>

In its brief USWC leaves the Court with the totally erroneous impression (Appellant's Brief, p. 52) that there are only a few additional services available from digital offices.<sup>54</sup> The Commission did not order modernization so that rural customers could have call forwarding and call waiting (custom calling services), but so that rural customers would have access to a modern telecommunications system. Mr. Selander, a USWC witness,<sup>55</sup> summarized the services available from a modern central office:

The market place is changing daily. Technology advancements are resulting in a multitude of new services which will be offered to USWC customers in the

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<sup>52</sup> USWC asserts in its brief that as long as basic exchange services, extended area service, in-state long distance and access to interexchange carriers are available from electromechanical offices then the Commission has no power to order modernization (Appellant's Brief, pp. 18-19, 53). Respondents acknowledge that customers located in rural Utah can complete local or long distance telephone calls. However, in the 1990s, the mere ability to complete a telephone call does not provide a residential or business customer access to the plethora of services available in a modern telecommunications system.

<sup>53</sup> Addendum 6, portions of the testimony of Division witness Fuller, summarizes the effects of an electromechanical switch on customers and the telecommunication system. Dr. Nina Cornell, a witness for MCI who lives in rural Wyoming and is served by the same type of central office which serves rural Utah, testified that among other problems, the electromagnetic switches caused "noise" in her computer communications, making use of electronic mail problematical. R. 2330-2. She also testified that sometimes service is lost. R. 2333. Finally, she testified that "no equal access...is a very real problem because...for me and for almost all of my neighbors, virtually everything we do is a toll call." Id.

<sup>54</sup> In its brief, Appellant only refers to custom calling services and equal access services as those services touted by proponents of modernization that are not available from electromechanical offices. USWC then asserts that those services are non-essential and therefore irrelevant to the issue of adequacy (Appellant's Brief, p. 52).

<sup>55</sup> Phillip Selander is the USWC Director of Network Facilities Engineering for Utah, Idaho, and Montana. He is responsible for engineering the telephone network in this region. He was USWC's main in-house witness in support of modernization.

1990's. Almost all of these new services require the capabilities of digital switching for full deployment. With the implementation of common channel signaling and packet switching, customers will be offered Integrated Services Digital Network (ISDN), digital centron, and Custom Local Area Signaling Services (CLASS). CLASS provides such services as automatic call-back, automatic recall, customer originated trace, calling number delivery, selective call forwarding, selective call rejection, and distinctive ringing. Additional services such as privacy call intercept, customized call screening, message based waiting, customized ringing, voice messaging, reminder service, and custom inquiry service are also being introduced. None of these services can be introduced in electromechanical offices. By upgrading the offices to digital, USWC will be in a position to offer these services at a significantly lower level of capital investment.<sup>56</sup>

R. 8129.

The Company also failed to mention the testimony of USWC witness Dr. William Davidson<sup>57</sup> (Addendum 7 is Dr. Davidson's exhibit 5) which describes not only the progression of technologies which have occurred since step-by-step offices (SXS) were introduced in the 1940s, but also the numerous services now available from digital technology.

R. at 7982-8011.

D. The Importance of a Modern Telecommunications System to Utah's Economic Development. USWC's brief does not even mention the term "economic development" or otherwise address the economic future of the State of Utah. In its Application and testimony before the Public Service Commission, however, it repeatedly emphasized that a modern telecommunications system is absolutely essential for the future economic development of the State, in particular, its rural communities. In USWC's Application for incentive ratemaking

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<sup>56</sup> R. 8129.

<sup>57</sup> Dr. Davidson is an associate professor of management at the University of Southern California and has focused his area of speciality on the international competitiveness of the U.S. economy with particular emphasis on the telecommunications and information technology industries. R. 7984.

(Addendum 5), one entire section is devoted to economic development and growth.<sup>58</sup> The Company acknowledges in its Application (Addendum 5, p. 2) that independent organizations such as the Governor's Blueprint for Utah's Economic Future, the Utahnet Task Force, the Utah Partnership for Educational and Economic Development, and the Information Technology Task Force have concluded economic growth in Utah is dependent upon the development of a modern up-to-date telecommunications infrastructure. Robert Fuehr, USWC's Chief Executive Officer for Utah, provided the Commission with significant testimony tying modern telecommunications and Utah's economic future (his testimony is attached as Addendum 8).<sup>59</sup> Governmental and community leaders who wrote letters in support of modernization

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<sup>58</sup> USWC Application, pp. 7-8. USWC indicates that replacement of the electromechanical central offices and enhancement of the fiber optic and digital network would promote economic growth in the following ways:

- Business Attraction. Businesses looking to locate in Utah invariably inquire about telecommunications services. They want both digital switching and access to fiber optic technology.
- Business Retention. A quality business climate, including access to modern technology (and the competitive edge it supplies), is essential to retain existing Utah businesses.
- Business Expansion. As small and medium size businesses grow they must maximize their use of limited resources. For example, one of the most common means of business expansion is to open branch offices, a move that requires reliable telecommunications for both voice and data. Modern technology provides the means to expand.

Id.

<sup>59</sup> The Court should make particular reference to Mr. Fuehr's view of the role of telecommunications and modernization on pp. 5-16 of Addendum 8. This testimony outlines the importance of a modern telecommunications system to the economic development and well being of the State of Utah. Mr. Fuehr concludes, "the economic development of Utah hinges, in part, on the availability of modern, quality communication facilities." (p. 9) Mr. Fuehr also makes it clear (p. 12) that absent a plan allowing USWC to share in over-earnings, it would be "many years before most of these remaining locations become modernized under existing economic criteria."

emphasized the necessity of a modern telecommunications infrastructure to economic well-being.<sup>60</sup>

E. The Profitability of the Upgrades. On pp. 19-23 of its Opening Brief, USWC addresses "evidence relating to the economics of the central office upgrades," pointing out that the Commission was unable to conclude that the proposed central office upgrades were uneconomical. USWC then describes Mr. Selander's<sup>61</sup> study on whether or not it would be economic to the company to replace or reinforce certain central offices.<sup>62</sup> USWC asserts that the Commission erred in not relying on Mr. Selander's CUCRIT study (Appellant's Brief, Addendum D) that the upgrade of the offices was uneconomic. (USWC Opening Brief at 55-59)<sup>63</sup> In so doing, USWC presents a misleading picture of the profitability of the investments to the company. Focusing only on the profitability of upgrading a particular central office, the Company's CUCRIT study concludes that the upgrade is uneconomical. The record and Commission's Order, however, are replete with evidence that the upgrade is

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<sup>60</sup> See supra, note 49 and accompanying text.

<sup>61</sup> USWC Opening Brief, Addendum D.

<sup>62</sup> The study performed by Mr. Selander measures benefits or lack of benefits to USWC in converting an individual office. The study takes into account the economics of converting a single central office or a group of central offices but does not take into account that the company will be allowed to earn its authorized rate of return on the investment made in these rural offices. Finally, a review of Addendum D to Appellant's Opening Brief shows that some offices have a positive net present value and some offices have a net negative value. The point is that the CUCRIT study measures the net present value to the company on an individual or group, office-by-office analysis, and does not address the numerous other economic issues surrounding modernization.

<sup>63</sup> As the Commission's Order points out (Addendum 3, p. 77), the CUCRIT study which USWC refers to in its Brief was submitted extremely late in the proceeding so that no party had adequate time to review the study or question its conclusions.

economical and profitable to the company overall. The Commission's conclusion that the modernization ordered is not uneconomical is easily supportable.

1. USWC Neglected the Evidence on Its Ability to Earn a Reasonable Rate of Return on Its Investment. The Commission's Order concluded that the investments in infrastructure, including the central office upgrades, presented virtually no risk to USWC because USWC will be allowed to include the investment in rate base and earn a rate of return on it.<sup>64</sup> The Commission added:

Normally, if a regulated utility undertakes an investment in infrastructure, it is subject to the risk of a prudence review before the investment is allowed in rate base. However, where the investment is mandated by the regulator, the risk is narrowed to the question of whether the investment has been implemented in a prudent manner.

Addendum 4, p. 5; R. at 5699. The CUCRIT study performed by USWC measured only whether certain individual offices being upgraded would be profitable. It is obvious that some individual offices in remote parts of the State will not be profitable. However, both profitable and unprofitable investments are included in USWC's rate base. USWC is then allowed to earn a reasonable rate of return on that investment, even if on an individual basis such a return would not be achieved.<sup>65</sup>

In its Report and Order, the Commission raised USWC's authorized rate of return from 11.8% to 12.2% in spite of its conclusion that:

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<sup>64</sup> See, for example, the Order on Review, Addendum 4, p. 5.

<sup>65</sup> In Utah, USWC has averaged rates for all locations whether or not it is located in a profitable exchange such as the Wasatch Front, or in an unprofitable rural exchange. Under this regulatory scheme, higher cost areas of the state are provided modern telecommunication services at reasonable rates because their costs are included in the overall revenue requirement of the utility.

Without dispute, capital costs have declined since the previous rate of return decision of 11.8%, and even since the filing of direct testimony. Taken alone, this would argue for reduction in allowed return. But other compelling factors have a role to play.

Addendum 3, p. 28; R. 5407. One of the reasons given by the Commission for raising the authorized rate of return to 12.2% relates directly to the investments ordered by the Commission:

The Company repeatedly stressed that its discretionary investment decisions are driven by profitability considerations, meaning in part that economic analysis or business case analysis is employed to rank alternatives. Implied at times and explicit at times was the message that jurisdictional rate of return allowed by Commissions could be the determining factor. The rate of return on equity in Utah is 11.8%, the lowest in the fourteen state USWC service territory. The Company's witnesses labeled that rate unreasonable and made the connection between it and discretionary investment aimed for the state...

[T]he Commission acknowledges the logic of the relationship between rate of return and investment decision making. Regulation presumes a reasonable management. This is a time when states are in a sense competing for high tech additions to and refinement of telecommunications plant and equipment. The Commission concludes that it is prudent to take these considerations into account when determining rate of return...the Commission is concerned enough with the factors enumerated in the discussion to raise the allowed return on equity capital to 12.2% from the existing 11.8%, and finds this return to be reasonable.

Addendum 3, pp. 29-30; R. 5408-09. In USWC's Statement of Facts, no mention is made of these economic considerations. USWC focuses only on its CUCRIT study instead of the broader economic issues obviously taken into account when the Commission found that it "cannot conclude that the proposed central office modernization is uneconomical." Addendum 3, p. 78; R. 5457; see generally pp. 73-81.

2. USWC Has Been Allowed to Depreciate Its Existing Electromechanical Central Offices under the Schedule Proposed in Its Incentive Plan. In its Statement of Facts USWC fails to mention, or even provide the Court a copy of the portion of the Order increasing its



revenue requirement almost five million dollars annually in order to more rapidly depreciate the existing central offices.<sup>66</sup>

3. USWC's Statement of Facts Fails to Emphasize Why the Commission Gave Little Weight to the CUCRIT Study. The Commission's Order states that it was not necessary to make a finding on whether the upgrades would be economical.<sup>67</sup> In any event, the CUCRIT study was filed so late that no party adequately reviewed it. As the Commission's Order indicates, other studies, which included a larger number of central offices in their analyses, concluded that, taken as a whole, modernization was marginally economic.<sup>68</sup>

### SUMMARY OF ARGUMENT--MODERNIZATION ISSUES

#### A. Modernization Arguments.

1. The Commission's Order requiring USWC to upgrade its facilities is supported by adequate findings of fact and substantial evidence. The Commission based its findings not only on Utah Code Ann. § 54-4-7, but also on § 54-4-1 (1992), § 54-4-8 (1992), and § 54-8b-11 (1992). These sections provide the Commission with the power to require a utility to upgrade facilities if it finds that either (1) existing facilities are inadequate or insufficient; or

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<sup>66</sup> See generally Addendum 3, pp. 14-17 and p. 75 for a discussion of how the Commission has provided rapid depreciation of the electromechanical offices. The Commission found that it "...has protected the company's recovery of investment by adopting liberal depreciation policies." Addendum 3, p. 75.

<sup>67</sup> This conclusion was based on the Commission's previous discussions on modernization, rate of return and depreciation.

<sup>68</sup> Prior to the hearing, the Committee had obtained through discovery from USWC a study on the economic feasibility of upgrading the rural offices which showed that the upgrade was marginally economical overall. R. at 6555-7.

William Dunkel, a Committee witness, filed supplemental surrebuttal testimony addressing USWC's late filed CUCRIT study which was not made part of the record on appeal. All parties agreed that it could be attached to Respondents' Brief as Addendum 9.

(2) that new facilities would promote the security or convenience of the public. The record is replete with evidence supporting the Commission's conclusion that the upgrades would benefit the public convenience. The Commission's order is also consistent with the legislative charge to make universal, high-quality telephone service available throughout the state. Utah Code Ann. § 54-8b-11 (1992).

2. The Commission's Order also contains sufficient subsidiary findings. USWC asserts that only those findings in bold constitute Commission findings. The Commission itself, however, stated that, "The discussion portion of our orders is important as it relates to the conclusions we reach, i.e., contains support for our findings and conclusions." Addendum 4, p. 11; R. at 5705.

#### B. Economic Arguments.

1. The Commission is not required to find that the modernization plan is economically feasible. USWC has an obligation to provide adequate service and make required improvements. In exchange for its investments, it has the opportunity to earn an authorized rate of return on those investments. The law does not require that each individual investment be economic. The Commission can require a monopoly to provide service to an unprofitable area. USWC will be allowed to place its investments in rate base and has been allowed accelerated depreciation on its existing electromechanical central offices. Finally, USWC was allowed an increase in its return on equity from 11.8% to 12.2%.

2. The Commission did not err in concluding not to rely on USWC's CUCRIT study. USWC's CUCRIT study measured the profitability of the upgrades solely from the company's perspective. The study was filed late and the other parties did not have an adequate

opportunity to review it. The Commission properly concluded, based on that study, that it could not determine that the proposed modernization plan was uneconomical.

C. Due Process Arguments.<sup>69</sup>

USWC had sufficient notice that the fiber backbone and educational network were going to be significant issues. The parties filed testimony on those issues and the Commission specifically addressed them in its Fourth Amended Scheduling Order. Moreover, USWC was the modernization plan's most ardent supporter, orchestrating letters and witnesses on its behalf. Having put the fiber backbone and educational network on the table, USWC should not now be heard to complain that it is now being denied due process.

**ARGUMENT--MODERNIZATION ISSUES**

**I. The Public Service Commission Has Adequate Statutory Authority to Order Modernization and the Commission's Decision Should Be Affirmed.**

In its brief, USWC cites only Utah Code Ann. § 54-4-7 (1992) as a basis for the Commission's authority to enter its Order in this case. Appellant's Brief, p. 41. USWC neither provides in its Brief nor cites the other statutory authority upon which the Commission based its decision (see Addendum 3, pp. 76-81).

Utah Code Ann. § 54-3-1 (1992) states that it is a duty of a public utility to:

... furnish, provide and maintain such service, instrumentalities, equipment and facilities as will promote the safety, health, comfort, and convenience of its patrons, employees, and the public, and as will be in all respects adequate, efficient, just and reasonable.

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<sup>69</sup> The Division, the Committee and MCI did not argue before the Commission for the fiber backbone and distance learning facilities and therefore do not join in this portion of the brief.

One of the factors the Commission can take into account in establishing just and reasonable charges or service is "the well-being of the State of Utah." Utah Code Ann. § 54-3-1 (1992).

The Commission has the authority to "supervise and regulate every public utility" in Utah, "to supervise all of the business" of said public utility, and "to do all things, whether herein specifically designated or in addition thereto which are necessary or convenient in the exercise of such power and jurisdiction." Utah Code Ann. § 54-4-1 (1992).

In telecommunications, the legislature has given the Commission specific direction when exercising its authority: the Commission must "endeavor to make available high quality, universal telecommunication services at just and reasonable rates for all classes of customers throughout this state." Utah Code Ann. § 54-8b-11 (1992), emphasis added.

USWC refers only to § 54-4-7 as the source of Commission authority and limits its discussion to whether the services being provided are adequate.<sup>70</sup> Both §§ 54-4-7 and 54-4-8, however, provide the Commission much broader authority. Utah Code Ann. § 54-4-7 states in pertinent part:

Whenever the Commission shall find, after a hearing, that the rules, regulations, practices, equipment, appliances, facilities, or service of any public utility, or the methods or manufacture, distribution, transmission, storage or supply employed by it, are unjust, unreasonable, unsafe, improper, inadequate or insufficient, the Commission shall determine the just, reasonable, safe, proper, adequate or sufficient rules, regulations, practices, equipment, appliances, facilities, service or methods to be observed, furnished, constructed, enforced or employed, and shall fix the same by its order, rule or regulation.

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<sup>70</sup> See USWC's Opening Brief at 41 and 53 where the Company attempts to tell the Court that all essential services are available from electromechanical switches (i.e., basic exchange, extended area service, in-state long distance and access to interexchange carriers), leading to the conclusion that as long as those services are available, the Commission has no power to order improvements.

This section clearly allows the Commission to determine whether a utility's equipment or service is inadequate or insufficient and, if so, to require that the utility furnish adequate and sufficient equipment and service to all Utah ratepayers.

Utah Code Ann. §§ 54-4-8 and 54-8b-11 are much broader than 54-4-7 and provide the Commission the authority to order improvements consistent with the duties of a public utility enumerated in § 54-3-1. Section 54-4-8 provides:

Whenever the Commission shall find that additions, extensions, repairs or improvements to or changes in the existing plant, equipment, apparatus, facilities, or other physical property of any public utility or of any two or more public utilities ought reasonably to be made, or that a new structure or structures ought to be erected to promote the security or convenience of its employees or the public or in any other way to secure adequate service or facilities, the Commission shall make and serve an order directing that such additions, extensions, repairs, improvements or changes be made or such structure or structures be erected in the manner and within the time specified in said Order.

(Emphasis added). Accordingly, under §§ 54-4-7 and -8, the Commission may order an upgrade of facilities whenever it finds either that existing facilities are inadequate or insufficient or that new facilities would promote the security or convenience of the public.

The Commission appropriately considered both of these statutory provisions in ordering USWC to proceed with the modernization. The Commission ordered the upgrades in light of, and consistent with, the legislative charge to make available universal, high-quality service throughout the State and to promote the safety, health, comfort and convenience of the utility's customers.<sup>71</sup>

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<sup>71</sup> In prior cases, this Court has given the Commission "considerable latitude of discretion to carry out its responsibilities of regulating utilities in the public interest." White River Shale Oil v. Public Serv. Comm'n, 700 P.2d 1088, 1091 (Utah 1985); Empire Elec. Assoc. v. Public Serv. Comm'n, 604 P.2d 930, 933 (Utah 1979); Utah Gas Serv. Co. v. Mountain Fuel Supply Co., 18 Utah 2d 310, 422 P.2d 530, 533 (Utah 1967).

## II. THE COMMISSION'S ORDER PROVIDES SUFFICIENT FINDINGS OF FACT.

USWC asserts that the Commission's Order on modernization should be reversed because its "ultimate" Findings of Fact, those findings set out in boldface type, are not supported by sufficient subsidiary findings (Appellant's Brief, p. 42). USWC bases its assertion that the only Findings of Fact and Conclusions of Law are the portions of the Order set forth in bold (Appellant's Brief, p. 40) on an exchange Mr. Smith had with Chairman Stewart on July 1, 1991 (Appellant's Opening Brief, Addendum E). USWC neglected to point out to the Court that the Committee was concerned enough about Commissioner Stewart's comment on that occasion that it requested a clarification in its Petition for Rehearing (R. 5607). In its Order on Rehearing (Addendum 4, p. 11), the Commission specifically addressed the Committee's concern:

All of the discussion in the report and order should be considered findings. The Commission is not a Court of law. We do not evaluate issues in the way a Court would. We do not take and consider evidence in the same way. It is true that we have quasi-judicial functions, but as an administrative arm of the Legislature, we also have quasi-legislative and on-going administrative responsibilities. We do not have the luxury of deciding a case and having done with it. That means that public policy concerns, informed judgment and forecasting always play a part in our determinations. We intend by this to draw attention to the fact that our orders are not going to be precisely like a court's orders. The discussion portion of our orders is important as it relates to the conclusions we reach, i.e., contains support for our findings and conclusions. So-called "findings" are bolded for convenience of parties, not because they constitute the only relevant parts of an order. If the Legislature intends that we operate as a court and that our orders be constructed like a court's in all respects, then it must alter the way utilities are regulated.

(Emphasis added). USWC's misleading statement in its Opening Brief that the only Findings of Fact are those in bold allows it to conveniently ignore all of the subsidiary findings and references to supporting evidence found throughout the Commission's Order. The purpose of

adequate findings of fact is to allow a reviewing court to determine that there is a logical and legal basis for the ultimate conclusions.<sup>72</sup> The totality of the Commission's Order provides substantial detail in its Findings of Fact, permitting a reviewing court to determine the logic and rationale for the decision.<sup>73</sup>

### **III. SINCE USWC DID NOT MEET ITS BURDEN OF MARSHALLING THE EVIDENCE, THE COMMISSION'S FINDINGS ARE CONCLUSIVE.**

After acknowledging that it has an obligation to marshal the evidence (Appellant's Brief, p. 17), USWC argues that the Commission's failure to make sufficient subsidiary findings has made it impossible for it to marshal the evidence.<sup>74</sup> Respondents assert that it is USWC which has failed to adequately marshal the evidence.<sup>75</sup> USWC having failed to marshal the evidence, this Court should sustain the Commission's findings as conclusive. See

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<sup>72</sup> See Appellant's Opening Brief, pp. 42-45 where it cites a number of Utah cases dealing with the purpose for which findings of fact are to be provided by an administrative agency. Nowhere does the Court restrict its review of a Commission order to the bolded portions in the Commission's decision. Instead, what is important to the Court is that there be a logical process that the agency used in reaching its decision.

<sup>73</sup> Although the Court will find adequate substantiation for the Commission's findings in its Report and Order, a recent Utah Supreme Court decision indicates that a reviewing court is not restricted to the explicit findings, but may examine the entire record in determining whether there is substantial evidence to justify a finding. Grace Drilling Co. v. Board of Review, 776 P.2d 63, 68 (Utah 1989).

<sup>74</sup> Appellant cites Adams v. Board of Review, 821 P.2d 1 (Utah Ct. App. 1991) for the proposition that when inadequate subordinate findings do not exist it is impossible for a petitioner to marshal the evidence (Appellant's Brief, p. 45) and then argues as a result of inadequate subordinate findings it was impossible for it to marshal the evidence and meet the obligations placed on it by the Court's decision.

<sup>75</sup> The proof of the assertion is evident from a review of Respondents' Statement of Facts, which refers to numerous portions of the record supporting the Commission's decision to order modernization that were not mentioned by USWC. See, *supra*, Respondents' Statement of Facts--Modernization Issues.

Boston First Nt. v. Salt Lake Cty. Bd., 799 P.2d 1163, 1165 (Utah 1990); Heinecke v. Dept. of Commerce, 810 P.2d 459, 464 (Utah App. 1991).

**IV. THERE IS SUBSTANTIAL EVIDENCE THAT THE MODERNIZATION PROGRAM ORDERED BY THE COMMISSION IS NECESSARY FOR ADEQUATE SERVICE AND TO PROMOTE THE COMFORT AND CONVENIENCE OF THE PUBLIC.**

A. The Legal Standard.

In Mulcahy v. Public Service Commission,<sup>76</sup> the Court addressed the duty of a public utility to enhance its service with changes in the economic and technological environment.

The Court examined the shifting standard of "convenience and necessity":

Necessity means reasonably necessary and not absolutely imperative.... [T]he convenience of the public must not be circumscribed by holding the term "necessity" to mean an essential requisite. It means a public need without which the public, people generally of the community, would be inconvenienced or handicapped in the pursuit of business or wholesome pleasure, or both....[I]t is necessary if it appears reasonably requisite, is suited and intends to promote the accommodation of the public...."

Mulcahy, 101 Utah at 250-51; 117 P.2d at 300 (citations omitted). The Court explained that the public convenience and necessity requires a forward looking approach to implementing technological improvements:

[T]he statute should be so construed and applied as to encourage rather than retard mechanical and other improvements in the quality of the service rendered the public . . . and should look to the future as well as the present, providing not only for present urgent need, but such as may reasonably be anticipated from the probable growth of population, industry and community development.

Id. The Court pointed out that service is not "adequate" just because "the community can 'get by.'"

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<sup>76</sup> 101 Utah 245; 117 P.2d 298 (Utah 1941).



To be adequate [the services] must safeguard the people from appreciable inconvenience in the pursuit of their business . . . [a]nd if a new or enlarged service will enhance the public welfare, increase its opportunities, or stimulate its economic, social, intellectual, or spiritual life to the extent that the patronage received will justify the expense of rendering it, the old service is not adequate.

Id. at 252-53; 117 P.2d at 301. In Union Pacific R. Co. v. Public Service Commission, 103 Utah 159; 135 P.2d 915 (Utah 1934), the Court recognized that the definition of adequate service can change with changing conditions:

Convenience and necessity are found, and consist largely, in the changing conditions and demands of the times. There was a time when the covered wagon, river scow, and pony express fairly well served the public needs, but as they became inadequate, there arose a need for railroad facilities.

135 P.2d at 918. In Re South Central Bell Telephone Co.<sup>77</sup> with findings similar to those in the present case, the Louisiana Public Service Commission recently ordered the telephone company to install central office upgrades and fiber optic lines. South Central Bell ("SCB") had proposed an incentive regulation plan which it claimed would encourage investments in upgrades and new construction. The witnesses sponsoring the SCB incentive regulation plan extolled the advantages of employing state of the art technology in Louisiana.<sup>78</sup> The

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<sup>77</sup> 121 Pub. Util. Rep. 4th (PUR) 338 (La. Pub. Serv. Comm'n 1991).

<sup>78</sup> Unlike Utah, the proposed incentive plan in Louisiana did not require the utility to adopt any specific construction project or provide a specific technology. SCB justified the plan by arguing that a higher rate of return was necessary to encourage it to invest in Louisiana instead of other states. Id. at 368. The Commission rejected SCB's incentive regulation plan and, instead, determined that it would fashion an incentive regulation plan of its own. Id. at 370. SCB's witnesses testified that "new innovations and a modern telecommunication industry are very important to economic development" Id. at 373; that a "leading edge telecommunications network is essential for both economic development and social progress" Id. at 373; that digital switching and fiber conductors in trunklines were important components of a modern network Id. at 373; that Louisiana lagged behind in the deployment of capital, to provide such a network; and that the budget for construction of networks would not greatly exceed the company's annual historic investment in the state. Id. at 373-74.

Commission, concluding that SCB would, "make adequate investment in [Louisiana] only if it is ordered to do so," ordered it to invest \$260 million annually for three years. The Commission relied on the testimony of the company's witnesses, stating:

Based on the testimony of South Central Bell, a modern telecommunications network is essential to economic prosperity and social progress and is therefore part of the utility's obligation to provide service. As the monopoly supplier with an exclusive franchise, South Central Bell may not choose to withhold investments that are essential to the well being of the community it serves...[T]he deployment of digital offices...and fiber conductors on an aggressive scheduling in Louisiana is necessary.

Id. at 374.<sup>79</sup>

B. Sufficient Evidence Exists in the Record Supporting the Commission's Ordering Modernization.

The Rural Office Upgrades. There is no magic formula capable of determining exactly when technological advances require a utility to modernize its facilities and services to meet present day standards. USWC contends that adequate service exists when only "essential" services such as basic exchange services, extended area service, in-state long distance, and access to interexchange carriers are necessary (Appellant's Brief, pp. 51-2). The Commission concluded, based on a voluminous record, that the public convenience and necessity today are not served by a telecommunications system which merely allows a customer to place and receive a phone call.<sup>80</sup> The Commission found that "the proposed central office upgrades

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<sup>79</sup> In this decision, the Louisiana Commission noted that the economic profitability of the new construction programs would not alter its conclusion reached in the case. See id. at 370-75.

<sup>80</sup> When asked if old-fashioned operator assisted calls would constitute "adequate" service in today's environment, USWC witness Mr. Selander indicated it would not be adequate service. R. 1713-14. The Commission recognized in its order that operator switched calls and multi-party lines which were once considered adequate are now inadequate, and noted that the company itself had acknowledged on the record that, "the simple ability to complete a

would make enhanced services and capabilities available to all USWC's customers including rural customers presently unable to obtain such services . . . "; that "the upgrades will provide for more accurate and clearer transmission of voice and data"; that it "will allow the offering of additional CLASS services"; that it will "provide more accurate processing of dial digits, faster touch tone services, faster call completion, clearer conversation, and more accurate data transmission"; and that "the purposed investment would be a benefit to and would meet a wide variety of residential, business, educational, and governmental and research needs."

Commission Report and Order, Addendum 3, pp. 72-3; R. at 5451-2. The Commission concluded, based on its subsidiary findings, that the central office upgrades were "clearly in the public interest." (Commission Order, Addendum 3 p. 73; R. at 5452.)

The Fiber Optic Backbone.<sup>81</sup> The Commission's conclusion that the installation of the fiber optic "backbone" was in the public interest is also supported by sufficient subsidiary findings and evidence. Such factors as the economic advantages of a digital infrastructure, the enhanced capacity of such a system to handle traffic, the creation of an educational network through digital transmission facilities, and the effect that such services would have on promoting economic development in general and rural development in particular, were factors considered by the Commission in ordering the fiber optic backbone (Commission Report and Order, Addendum 3, p. 71; R. at 5150).

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call in today's environment does not constitute adequate service." R. 5459.

<sup>81</sup> As noted above, the Division, Committee and MCI do not join in this portion of the Brief.

C. USWC Itself Proposed the Modernization Plan and Its Witnesses' Testimony Provided Record Evidence Supporting the Commission's Decision.

USWC's witnesses in this case testified to the substantial economic, quality of service, and educational benefits of the modernization plan to Utah, particularly to rural Utah. Having demonstrated that the upgrades would promote the public comfort and convenience and contribute to the economic and educational well-being of the state, USWC cannot now credibly assert that present service is adequate without the upgrades.

This is not a case in which USWC opposed modernization from the beginning and is now appealing from a decision ordering its implementation. USWC proposed the modernization plan as part of its incentive regulation plan; USWC witnesses extolled the benefits of the plan not only to rural customers who would finally have the same technological opportunities as urban customers, but also to the rest of the state. USWC testified that the plan would greatly enhance the state's economic and educational base. All of the evidence presented by USWC was directed toward demonstrating the desirability of providing adequate and convenient service to the residents of the state of Utah. The Commission noted as much in its Order denying a stay:

The only real fault which the company finds with the modernization investments we have ordered is that we haven't agreed to USWC's proposed incentive plan, which, in our judgement, would have resulted in windfall profits for USWC. However, at the outset of this case, USWC pitched the very same investments ordered by the Commission, claiming that these investments were necessary and would prove to be highly beneficial, and its witnesses, as well as others, justified and substantiated those investments during the hearing. Now it is clear that what USWC really meant was that the upgrades were needed only if the company were allowed to make as much money as it wants. When the Commission determined that something less was appropriate, then, magically, the upgrades weren't really necessary: they were simply a luxury offered as bait for the company's incentive plan.

Addendum 10, p. 3; R. at 5747. The modernization plan ordered by the Commission is the same modernization plan proposed by USWC; the time allowed for USWC to make these investments is the same time frame within which the Company agreed to make the investments in its original application. USWC was the plan's most ardent proponent. It is outrageous that as soon as the Commission denied the portion of the incentive plan that would have allowed USWC an opportunity to earn an unreasonable rate of return, USWC suddenly began to argue that there was insufficient evidence to support the Commission's Order to modernize.

**V. THERE IS NO LEGAL REQUIREMENT THAT THE COMMISSION FIND THE MODERNIZATION PLAN ECONOMIC.**

USWC relies on Mulcahy v. Public Service Commission,<sup>82</sup> as its authority requiring the Commission to make a finding on economics, acknowledging that the portion of Mulcahy on which it relies is dictum (Appellant's Brief, p. 54). A fundamental principle of public utility regulation is that all customers are entitled to adequate and convenient service, even if it may be uneconomic to the utility to provide the service to some of these customers. A fundamental principle of monopoly regulation is that if the utility accepts the duty to serve, a regulator can require the monopoly to provide service in unprofitable areas. In exchange for being required to provide service in unprofitable areas, the utility is entitled a reasonable opportunity to earn its authorized rate of return on its investment.<sup>83</sup> If a portion of the

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<sup>82</sup> 101 Utah 245; 117 P.2d 298 (Utah 1941).

<sup>83</sup> Los Angeles & Salt Lake R. Co. v. Public Serv. Comm'n, 121 Utah 209, 240 P.2d 493 (1952); See also Omaha Transit Co. v. Briggs, 94 N.W.2d 461, 475 (Neb. 1959) (service to all of the public required "where it is unprofitable as well as it is profitable"). Repairs and improvements to a public utility system may be ordered even though the immediate result would be a financial loss to the utility. Colonial Prods. Co. v. Pennsylvania Pub. Util. Comm'n, 146 A.2d 657, 659 (P. Sup. Ct. 1959); see also Re South Central Bell Tel. Co., 121

territory served by a utility is not profitable, but the company's service as a whole produces a fair return on its investment, the utility can be required to serve an unprofitable portion.<sup>84</sup>

In Los Angeles and Salt Lake Railroad Co. v. Public Service Commission, 121 Utah 209, 240 P.2d 493 (Utah 1952), the railroad applied to the Public Service Commission to allow it to discontinue its practice of providing an agent at Black Rock Station except for two months during the year. The railroad argued that an agent was only necessary during the months of April and May when sheep were shipped in and out of Black Rock. There was evidence that for the other ten months of the year expenses were greatly in excess of revenues, and the railroad contended that the economics prohibited maintaining an agent during those ten months. The Utah Public Service Commission noted that wool was clipped and shipped from Black Rock during October and November; that some other commodities were shipped year round; that it may be necessary to ship in hay and feed during a bad winter; and that sheep men had been accustomed to transacting business during the winter at a warm station with a telephone, and ordered the railroad to maintain an agent at the station. In reviewing the Commission's decision, this Court stated:

If the cost of maintaining an agent during the winter months ...were the only factor to be considered there would be no doubt that the Commission acted unreasonably in ordering the plaintiffs to maintain an agent during those months. However, though the cost-revenue factor is a very important element in determining the reasonableness of the Commission's order, it is not the sole factor. Another important factor which must be considered is: will a non-agent station reasonably serve the public desiring to use the railroad's facilities.

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Pub. Util. Rep. 4th (PUR) 388 (La. Pub. Serv. Comm'n. 1991).

<sup>84</sup> Fairview Water Co. v. Pennsylvania Pub. Util. Comm'n, 422 A.2d 1209 (Pa. Cmwh. 1980).

Id. at 211; 240 P.2d at 495. See also Los Angeles & Salt Lake R. Co. v. Public Serv. Comm'n, 80 Utah 455; 15 P.2d 358 (Utah 1932) (cost revenue factor in determination of what is a reasonable and adequate service is one of the main and important factors, but not the sole factor; such determination depends upon all of the circumstances and facts bearing upon the situation). Despite the economic unprofitability of the service, the Court held that the Commission could reasonably conclude that the public convenience and necessity required the services of an agent during the winter months. 121 Utah at 211; 240 P.2d at 496.

USWC argues (Appellant's Brief, p. 55) that the Commission's Order is flawed because the Commission did not make a finding that the modernization plan was economically feasible. In its Report and Order, the Commission stated: "We do not agree that we must make such a finding [that the modernization plan is economic]. Nevertheless, we are of the view that the program may on the whole be economical." (Addendum 3, p. 77). The Commission chose not to rely on USWC's CUCRIT study, and found that the modernization plan was not uneconomical.

USWC's attitude toward the authority of regulators to order modernization of Utah's telecommunication's network manifest itself most clearly in the Company's request for a stay of the Commission's Order. In an affidavit supporting that request, Mr. Fuehr, USWC's CEO for Utah, unabashedly expressed his Company's intention to invest its money wherever it wanted:

The Commission has stated that it will allow a reasonable return to be earned on these investments and that, therefore, they are without risk. Such an approach fails to recognize that USWC and its parent US West, Inc. as managers of the capital on behalf of investors have a variety of options as to the use and deployment of capital. Among these options are the use of capital in projects with a greater return potential than a regulated utility return. Thus, the fact that USWC may be given the opportunity to

earn a regulated utility return does not obviate the myriad other potential investment opportunities.

Addendum 10, p. 2. In its Order denying USWC's request for a stay, the Commission responded:

This statement [of Mr. Fuehr] is made in the context of a request for a stay of our order, nevertheless, it seems to reflect USWC's present attitude toward utility investments generally. In our judgment, this attitude stands traditional regulation on its head. It is apparently the company's view that utility investment is simply one among many investment opportunities. While it used to be that for a monopoly provider, a public service obligation was paramount, now, in Mr. Fuehr's view, the provider is free to play one investment option against another, including utility investments. The Commission is therefore put in the position of having to bid, literally, against other non-utility investment options, real or imagined, in order to insure the utility investments required for service adequacy are made.

Addendum 10, pp. 2-3.

USWC argues that the Commission committed clear error by not making a finding that modernization is uneconomic based on its CUCRIT study. The Commission, however, viewed the economics of modernization from the point of view of a regulator with the public interest in mind. There is no law which requires that each individual investment ordered be economic, or that the Commission find that the investments are economic. The Commission did not ignore economics. Instead, it increased USWC's rate of return<sup>85</sup> and accelerated its depreciation. With respect to depreciation, the Commission stated in its Report and Order:

In past decisions, the Commission has granted shorter asset lives and thereby increased depreciation expense. One result of this policy has been to protect the company from the risk of technological obsolescence. Another has been to enhance the company's positive cash flow, thus enabling it to continue to expand and modernize the Utah infrastructure. The Commission finds that there is an implied relationship between its depreciation policy and its expectations for prudent and economic future investments.

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<sup>85</sup> See the Commission's lengthy discussion on rate of return in its Report and Order. Addendum 3, pp. 18-33, esp. 29-30.



Addendum 3, p. 17. And in its Order on Review, the Commission stated:

We would note that if the modernization program is not accomplished, present rates will be excessive because we have allowed depreciation rates to reflect the remaining lives of old equipment commensurate with the upgrades and replacement in the modernization program.

Addendum 4, p. 6.

# **VI. USWC WAS NOT DENIED DUE PROCESS BY THE COMMISSION ORDERING THE FIBER BACKBONE AND DISTANCE LEARNING INVESTMENTS.**

The Commission did not deny USWC due process of law when it ordered the company to invest in the fiber backbone and distance learning facilities.<sup>86</sup> USWC was clearly put on notice by the Commission as early as November, 1990, that modernization was an issue:

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<sup>86</sup> It is important to understand that USWC makes this claim only with respect to the fiber backbone system from Nephi to St. George and the distance learning facilities and does not claim that it lacked adequate notice with respect to the upgrade of the various rural central offices. It is also important to recognize that USWC was not ordered to make any investments in the distance learning facilities, but only to investigate the feasibility of distance learning facilities. The Commission's Order stated:

The Commission further finds that the company must work with the Division and the various interested educational interests in the state to devise a program entailing the investment for extending fiber to these institutions as part of the total modernization plan. Such plan shall include details of the rates to be charged education for use of the network. Institutions should be required to sign contracts, or otherwise demonstrate that they will utilize the fiber optic service and pay the rates determined, before construction is authorized. Such plan shall be submitted to the Commission within three months of this order.

Addendum 3, p. 83).

USWC believed it was unclear what was required with respect to the distance learning and sought clarification from the Commission. In the Commission's Order Denying Stay (Addendum 10, pp. 5-6), the Commission stated:

The educational fiber optic extensions were hortatory only; we have set no deadline for the extensions and the company need only file a plan with us in whatever detail is reasonable under the circumstances.

"Hortatory" means "advisory"; therefore, the only investment in question is the fiber backbone from Nephi to St. George. USWC is under no current order by the Commission to install fiber to the educational facilities.

Finally, the Commission notes that it has full authority under present law to consider the adequacy of the company's plant and equipment, its capital budget, and its longer-range investment plans. In Docket No. 88-049-07, for example, the company's investment decision making was thoroughly reviewed and found, on standard economic and business principles, to be more than adequate. An analysis of various types of plant and equipment was also conducted and suggestions of overinvestment were generally rebutted. The status of telecommunications plant and equipment investments, and the company's latest proposed replacement or upgrade schedule, has been the subject of much public discussion, mostly generated by the company itself in support of its broader objective to obtain a change in regulation to the incentive form. The company is on notice that investment or modernization in the state generally is a plant and equipment issue like any other in that the rate case is the proper place for full regulatory consideration. Should the case be made for new plant, the Commission will order it.

R. at 4627-8. Although it is correct that both the Division and the Committee gave specific notice to the Commission and parties that they intended to argue that the central office upgrades be required by the Commission independently of the incentive plan, USWC, as author and chief proponent of the fiber backbone proposal, cannot now argue in good faith that it had no notice the fiber backbone was an issue.

The United States Supreme Court has stated that, "[t]he essential requirements of due process...are notice and an opportunity to respond." Cleveland Bd. of Educ. v. Loudermill, 470 U.S. 532, 546 (1985). The Utah Supreme Court discussed these notions in the public utility context in Salt Lake County v. Public Service Commission, where the county asserted that it had been denied due process in a Commission proceeding. The court held:

We think that plaintiff hardly can complain of surprise or lack of notice. The record abounds with facts reflecting that it knew what was afoot, and when, where, and why it was. Opportunity to examine everything, cross examine anyone and otherwise...was granted.

Salt Lake County v. Public Serv. Comm'n, 510 P.2d 923, 924 (Utah 1973).

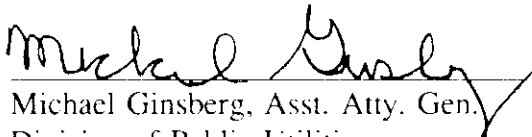
These requirements have clearly been met in the instant case. As noted above, this is not a situation where USWC is being required to make an investment without participating in a proceeding. USWC was an enthusiastic proponent of its modernization plan. It presented witnesses in support of modernization and orchestrated numerous educational and public officials throughout the state to appear on its behalf.

### CONCLUSION


Careful review and analysis of the facts and authorities cited by Appellant reveals that they do not support USWC's claims that the Commission erred either on the Stipulation issues or the modernization issues. The Commission's Order is supported by the facts and the law and should be affirmed.

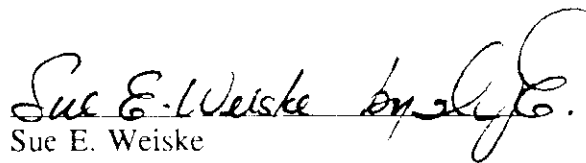
DATED this 16th day of April, 1993.

  
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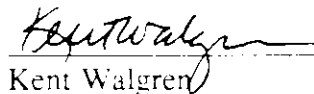
  
Sue E. Weiske  
MCI Telecommunications Corporation

## CERTIFICATE OF SERVICE

I hereby certify that on the 16th day of April, 1993, I caused four (4) copies of the foregoing **Brief of Respondents Utah Public Service Commission, Division of Public Utilities, Committee of Consumer Services, and MCI Telecommunications Corporation** to be mailed, first class mail, postage prepaid, to the following:

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## Addendum 1

### Determinative Statutes

#### **54-3-1. Charges must be just; service adequate; rules reasonable.**

All charges made, demanded or received by any public utility, or by any two or more public utilities, for any product or commodity furnished or to be furnished, or for any service rendered or to be rendered, shall be just and reasonable. Every unjust or unreasonable charge made, demanded or received for such product or commodity or service is hereby prohibited and declared unlawful. Every public utility shall furnish, provide and maintain such service, instrumentalities, equipment and facilities as will promote the safety, health, comfort and convenience of its patrons, employees and the public, and as will be in all respects adequate, efficient, just and reasonable. All rules and regulations made by a public utility affecting or pertaining to its charges or service to the public shall be just and reasonable. The scope of definition "just and reasonable" may include, but shall not be limited to, the cost of providing service to each category of customer, economic impact of charges on each category of customer, and on the well-being of the state of Utah, methods of reducing wide periodic variations in demand of such product, commodities or services, and means of encouraging conservation of resources and energy.

#### **54-4-1. General jurisdiction.**

The commission is hereby vested with power and jurisdiction to supervise and regulate every public utility in this state, and to supervise all of the business of every such public utility in this state, and to do all things, whether herein specifically designated or in addition thereto, which are necessary or convenient in the exercise of such power and jurisdiction, provided, however, that the department of transportation shall have jurisdiction over those safety functions transferred to it by the Department of Transportation Act.

#### **54-4-7. Rules, equipment, service --- Regulation after hearing.**

Whenever the commission shall find, after a hearing, that the rules, regulations, practices, equipment, appliances, facilities, or service of any public utility, or the methods of manufacture, distribution, transmission, storage or supply employed by it, are unjust, unreasonable, unsafe, improper, inadequate or insufficient, the commission shall determine the just, reasonable, safe, proper, adequate or sufficient rules, regulations, practices, equipment, appliances, facilities, service or methods to be observed, furnished, constructed, enforced or employed, and shall fix the same by its order, rule or regulation. The commission, after a hearing, shall prescribe rules and regulations for the performance of any service or the furnishing of any commodity of the character furnished or supplied by any public utility, and on proper demand and tender of rates such public utility shall furnish such commodity or render such service within the time and upon the conditions provided in such rule.

#### **54-4-8. Improvements, extensions, repairs — Regulations — Apportioning costs.**

Whenever the commission shall find that additions, extensions, repairs or improvements to or changes in the existing plant, equipment, apparatus, facilities or other physical property of any public utility or of any two or more public utilities ought reasonably to be made, or that a new structure or structures ought to be erected to promote the security or convenience of its employees or the public or in any way to secure adequate service or facilities, the commission shall make and serve an order directing that such additions, extensions, repairs, improvements or changes be made or such structure or structures be erected in the manner and within the time specified in said order. If any additions, extensions, repairs, improvements or changes, or any new structure or structures which the commission has ordered to be erected, require joint action by two or more public utilities, the commission shall notify the said public utilities that such additions, extensions, repairs, improvements or changes, or new structure or structures have been ordered, and that the same shall be made at their joint cost; whereupon the said public utilities shall have such reasonable time as the commission may grant within which to agree upon the portion or division of cost of such additions, extensions, repairs, improvements or changes or any new structure or structures which each shall bear. If at the expiration of such time such public facilities shall fail to file with the commission a statement that an agreement has been made for division or apportionment of the cost or expense of such additions, extensions, repairs, improvements or changes, or of such new structure or structures, the commission shall have authority, after further hearing, to make an order fixing the proportion of such cost or expense to be borne by each public utility and the manner in which the same shall be paid or secured.

#### **54-7-1. Rules of practice — Evidence — Informalities disregarded — Limitation of issues.**

All hearings, investigations and proceedings shall be governed by this chapter. The commission shall adopt rules pursuant to the Utah Administrative Rulemaking Act to govern the regulation of public utilities. These rules shall include: (a) provisions for the discovery of information, including the confidentiality of information submitted to the commission and sanctions for failure to make discovery; and (b) provisions governing the practices and procedures in hearings, investigations and proceedings of the commission. The rules shall be designed to simplify and expedite proceedings, eliminate unjustifiable expense and delay, and enhance the fairness and effectiveness of the fact finding process. In the conduct of proceedings before the commission the technical rules of evidence need not be applied. No informality in any hearing, investigation or proceeding, or in the manner of taking testimony, shall invalidate any order, decision, rule or regulation made, approved or confirmed by the commission.

Informal resolution, by agreement of the parties, of matters before the commission shall be encouraged. These agreements shall be subject to the approval of the commission and the commission shall give due regard to the interests of the public and other affected persons before issuing orders approving any agreement.

The commission may, at its sole discretion in cases or procedures involving rate increases as defined in § 54-7-12, limit the factors and issues to be considered in the determination of just and reasonable rates.

#### **54-8b-11. Establishing just and reasonable rates.**

In administering this title, the commission shall endeavor to make available high-quality, universal telecommunications services at just and reasonable rates for all classes of customers throughout this state.

## Addendum 2

### Relevant Provisions of the Stipulation on Revenue Requirement



## Respondents' Addendum 2

### RELEVANT PROVISIONS OF STIPULATION

(Note: The full text of the Stipulation and Joint Motion on Revenue Requirement Issues, dated October 30, 1990, is provided in USWC's Opening Brief, Addendum B.)

1. That the Division "has engaged in extensive discovery on revenue requirement issues. The CCS also engaged in discovery on revenue requirement issues. R. at 4568.

2. That "the parties have resolved all issues relating to the calculation of revenue requirement in this matter, with the exception of the following:

- a. Rate of Return on Equity.
- b. Capital Structure.
- c. Depreciation Represcription.

R. at 4569 (emphasis added).

3. That Joint Exhibit 1 (JE-1), attached to the Stipulation, "sets forth the adjustments that the parties have agreed to and which the Commission should incorporate into its final revenue calculation in this case. For illustrative purposes, the parties have calculated JE-1 using six months actual results which have been annualized and normalized...The final calculation of revenue requirement will use updated results, as described below...." R. at 4571.

4. That "the parties agree that several of the columns in JE-1 shall be updated monthly with additional actual data. At the time of the December hearings, the parties will provide the latest updated JE-1 which will present nine months actual results on an annualized and normalized basis consistent with the annualization and normalization of six month's actual data in JE-1. The method of calculation shall be the same as in Exhibit JE-1. Subsequent monthly updates will be provided to the Commission." R. at 4573.

5. That all columns on JE-1 shall be updated, with the exception of Columns 2-11, B,C,I,J,X-Q,S-V. R. at 4573-74.

6. That the final order would include an update of JE-1 "for at least 11 months actual test year results...." R. at 4575.

7. That the Stipulation represented a settlement of some issues that would have been disputed absent the Stipulation. "The settlement of revenue requirement issues in the manner set forth on JE-1 represents a balanced approach to the revenue requirement issues resolved...." R. at 4576.

8. That the Stipulation was an integrated agreement, the provisions were dependent upon each other, and the purpose of the Stipulation was "to settle in their entirety, all revenue requirement issues...Therefore, if it is not accepted in its entirety, the parties are free to withdraw therefrom." R. at 4577 (emphasis added).

9. That "with respect to matters expressly agreed to in this Stipulation" the parties are barred from seeking review, rehearing, and judicial review. R. at 4577.

### Addendum 3

PSC Report and Order dated June 19, 1991, in Docket  
Nos. 90-049-03 And 90-049-06

# DOCKETED

- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

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In the Matter of the Application	)	<u>DOCKET NO. 90-049-03</u>
of US WEST COMMUNICATIONS for	)	
Approval of an Incentive Regulation	)	
Plan.	)	
	)	<u>REPORT AND ORDER</u>
In the Matter of the Investigation	)	
into the Reasonableness of the	)	
Rates and Charges of US WEST	)	<u>DOCKET NO. 90-049-06</u>
COMMUNICATIONS.	)	

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ISSUED: June 19, 1991

SHORT TITLE
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1990 General Rate Case
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## SYNOPSIS

The Commission herein orders a reduction in revenue requirement of \$19,799,000. The reduction is based on a stipulation by the parties on all issues except depreciation expense and cost of capital, which is set by the Commission at 12.2 percent rate of return on common equity and 10.93 percent rate of return on investment. Revenue requirement reductions ordered in this docket, the sum of two interim reductions and this final one, total \$38,748,000. In addition, the Commission adopts a proposal to invest in central office and transport plant and equipment to modernize and upgrade the network. The Commission also formulates an "incentive regulation" plan which, if implemented, would permit the Company to retain a share of excess earnings, if any, over the allowed rate of return, as an incentive to promote more efficient utility operations.

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I. PROCEDURAL HISTORY

On March 2, 1990, US WEST Communications (USWC or the Company) filed an application with the Commission seeking approval of an incentive regulation plan. Docket No. 90-049-03 was assigned to the case. As part of the application, USWC provided a general description of its proposed plan, which contained both incentive regulation and network modernization proposals. On March 16, 1990, the Committee of Consumer Services (Committee) filed a Motion to Dismiss Application and Strike Docket on the ground that Senate Bill 115, the legislation that enacted Utah Code Ann. Section 54-4-4.1 (1991), had not yet become law. On March 26, 1990, USWC filed its detailed Utah Incentive Regulation Plan.

On March 28, 1990, the Division of Public Utilities (Division) filed a Petition in Docket No. 90-049-06 seeking an investigation into the reasonableness of the rates and charges of USWC and requesting a hearing to consider an interim rate reduction of \$5.7 million.

On April 27, 1990, the Committee withdrew its Motion to Dismiss when USWC agreed that its application be deemed to have been refiled on April 27, 1990. In its Order of May 10, 1990, the Commission ruled that USWC's application and other pleadings relating to incentive regulation would be deemed to have been refiled as of April 27, 1990 without the necessity of actually refiling them. In the same order, the Commission ordered that Docket Nos. 90-049-03 and 90-049-06 be "consolidated for purposes of hearing only," and

established a schedule for filing of testimony and for hearings. The Commission required that analyses of both the incentive and the modernization plans consider the current definition of "universal service" as well as what would be required when the term of a plan ended. In late April 1990, the Division and the Committee filed testimony in support of their requests for an interim decrease. On May 1, 1990, the Committee filed a motion requesting that the Commission reduce rates on an interim basis by \$16 million. On May 18, 1990, USWC filed responsive testimony regarding the proposed interim rate decrease. The Division filed supplemental testimony on May 18 and May 23, 1990, increasing its requested interim decrease to \$8.6 million. Hearings were held on May 24-25, 1990. Following the hearings, various parties filed briefs summarizing their positions regarding the proposed interim rate decrease. On June 22, 1990, the Commission ordered an interim rate decrease of \$10.65 million, based on a 1989 test year, 11.8 percent return on equity, and adjustments consistent with those ordered in Docket No. 88-049-07. The Commission also determined that the standards for interim rate decreases and increases need not be the same.

On June 29, 1990, USWC filed its direct testimony on incentive regulation issues, as well as amendments to its proposed Utah Incentive Regulation Plan. On July 12, 1990, the Commission issued its order amending the schedule. On July 20, 1990, parties (other than USWC) filed position statements on incentive regulation issues. On August 14, 1990, the Commission issued its Second Amended Scheduling Order revising some of the filing and hearing dates. On



August 27, 1990, various parties filed their preliminary revenue requirement calculations. On September 8-9, 1990, the Second Amended Scheduling Order was published in the Salt Lake Tribune and the Deseret News. In early October 1990, various parties filed testimony on rate of return and capital structure issues.

On October 24, 1990, all parties filed testimony in response to USWC's proposed incentive regulation plan. On October 30, 1990, USWC, the Division, the Committee, and AT&T entered a Stipulation and Joint Motion on Revenue Requirement Issues, resolving most revenue requirement issues, and calling for a further interim reduction of \$8.238 million to be implemented January 1, 1991. On October 31, 1990, James L. Barker, representing himself and six other intervenors, filed a Request for Declaratory Order challenging the constitutionality of 54-4-4.1, the statute that enables the Commission to adopt earnings sharing plans like the one proposed by USWC. On November 1, 1990, the Commission issued its Third Amended Scheduling Order. On November 23, 1990, the Commission issued its Fourth Amended Scheduling Order in which it ordered parties to consider the effects of demand for service on depreciation, and stated that the determination of revenue requirement must address the persistence of overearnings. In addition, the Commission ordered that the interim rate reduction be spread on an equal percentage basis to residence and business local exchange services, toll, and switched access, excluding nonrecurring charges, and stated the Commission's determination of its authority to order investments to upgrade the system. On November 26, 1990, the parties filed rebuttal

testimony on rate of return and capital structure issues. On December 4, 1990, pursuant to the request of the Company, the Commission issued a Revised Public Notice of Hearing, which was published in the Salt Lake Tribune and the Deseret News on December 8-19, 1990, and which was mailed directly to all persons and entities who had filed letters with the Commission indicating an interest in incentive regulation and network modernization issues. On December 8, 1990, the parties filed surrebuttal testimony on rate of return and capital structure issues. On December 17-19, 1990, the Commission held hearings on the Stipulation and Joint Motion on Revenue Requirement and on rate of return and capital structure issues. By order issued January 3, 1991, the Commission approved the Stipulation pursuant to its terms. On January 11, 1991, the parties filed briefs on rate of return and capital structure issues. On January 16, 1991, all parties filed rebuttal testimony on incentive regulation issues. On January 18, 1991, the parties filed testimony on depreciation represcription issues. Also on January 18, 1991, several parties filed briefs and motions responding to Mr. Barker's Request for Declaratory Order. On January 22, 1991, the parties filed direct testimony on rate design issues. In late January and early February 1991, various witnesses filed additional testimony on depreciation represcription issues. The Commission held a hearing on February 8, 1991 on depreciation represcription. Also on February 8, 1991, Mr. Barker filed a Reply Memorandum regarding the constitutional issues. On February 15, 1991, the parties filed surrebuttal testimony on incentive regulation issues and rebuttal

testimony on rate design issues. On February 22, 1991, the Commission issued an order dismissing Mr. Barker's Request for Declaratory Order. Hearings on incentive regulation and rate design issues commenced on February 28, 1991 and concluded on March 13, 1991.

On April 19, 1991, USWC, the Division and the Committee filed position statements regarding disputed issues relating to the Stipulation and Joint Motion on Revenue Requirement Issues. On April 26, 1991, the same parties filed responsive position statements. On May 1, 1991, USWC moved that the Commission accept the position statements as evidence in this proceeding and sought oral argument. On May 15, 1991, USWC, the Division and the Committee presented oral argument on the disputed issues relating to the Stipulation and the position statements were accepted as evidence in this proceeding.

## II. DISCUSSION, FINDINGS, AND CONCLUSIONS WITH RESPECT TO REVENUE REQUIREMENT

### A. STIPULATION

On October 30, 1990, the parties entered into a Stipulation that was intended to resolve all revenue requirement issues except depreciation and cost of capital, which were reserved for later hearing. Following hearings on December 17th, the Commission adopted the Stipulation by order issued January 3, 1991.

The October Stipulation was based on the first six months of 1990 actual results of intrastate operations then available and the Company's budget estimates for the calendar year 1990.

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Attached to the Stipulation was a Joint Exhibit in which 32 adjustments to actual results were identified. The value of 23 of the adjustments were to be held fixed, including the June 22, 1990 interim rate reduction, and the value of the remaining nine adjustments were to be updated when actuals for all 12 months of 1990 became known. The intent of the signatory parties to rely on the Stipulation as crafted and to exclude consideration of further adjustments is made clear in paragraphs six and seven of the Stipulation.

The Stipulation is a negotiated settlement of revenue requirement issues, as distinct from each party advancing its own interest through discovery and hearing, in an adversarial way, on every single issue. Negotiation is a process of compromise in the interest of reaching an end result that each party is able to accept. The Commission has criticized this process of bargaining and compromise before, because it leaves the Commission unaware of important details. The Commission knows only outcomes. In addition, and perhaps most importantly, some issues have been "decided" in the course of the negotiations without having been brought to the Commission's attention. Therefore, the Commission has been reluctant to accept stipulations in recent major cases, and, where stipulation seemed the prudent course, has sought to confine them to purely technical as distinct from policy issues.

In the current docket, stipulation was entertained as the reasonable course in order to free up Company and regulatory resources to deal with the Company's incentive and modernization

proposals. Also, it seemed revenue requirement issues, according to the parties, could be resolved in conformance with Commission decisions rendered in the previous, recently concluded Docket No. 88-049-07. Since the issues were not to be reargued, the policy aspect was removed, and resolution would be on technical grounds.

It is in this context that, later in the docket proceedings, parties began to argue the meaning of the Stipulation's limitation on updates and adjustments of test year data. USWC proposed four new adjustments to test year data, on issues the other signatory parties had not seen at the time the Stipulation was signed and which had the effect of increasing revenue requirement. The Division then sought to update several of the 23 adjustments which the Stipulation said could not be updated and which had the effect of decreasing revenue requirement. The Committee argued that the plain meaning of the Stipulation prevented either the introduction of new adjustments or the updating of fixed adjustments, and urged the Commission to reject them both.

The Commission could not have been presented a more penetrating example of the problematic nature of stipulations. Here, signatory parties could not agree what their own words meant, and seized this dispute as an opportunity to advance their own interests on what otherwise might have been reasonable grounds. USWC argued its proposed new adjustments were of the sort routinely permitted in the normal fashioning of a test year. With the full 12 months of 1990 actual results of operations information in hand, the Division

argued the superiority of these "actuals" to the budget information upon which the Stipulation was based.

When the Commission accepted the Stipulation on January 3, 1991, the nature of the document as a compromise based on the best information then available to the parties was clearly understood. That each party must have given up something in signing the Stipulation, and might on some issues have argued differently if given the chance in an adversarial proceeding, goes without saying; that is the very purpose of negotiation in a settlement conference. It is what is meant by stipulation. Parties cannot now come back to the Commission and attempt to redefine things to their own advantage. To do so places the Commission at an unacceptable disadvantage and severely compromises case proceedings. The record does not contain full examination of contested issues. The Division has not audited the 1990 information and neither the Division nor the Committee can state what, except for the agreement reached in the Stipulation itself, the test year would ideally be.

There has also been some discussion about what the parties could, did, or should have understood was contemplated by the Stipulation. At this point in time, all that is important is what the Commission understood to be stipulated to by the parties at the time it accepted the Stipulation. None of the adjustments now argued for by USWC or the Division were considered open issues by the Commission. On this basis, the Commission has two choices. The Stipulation can be accepted without alteration except as specifically permitted by its terms, or the case record can be reopened for

receipt of further information intended to redefine the test year. Reopening the record is not acceptable. To do so would be tantamount to beginning the revenue requirement determination anew. There is no doubt that each moment's delay in reducing rates costs ratepayers money. This the Commission cannot countenance. Therefore, the Commission concludes the Stipulation must be accepted essentially unaltered. Parties are, as always, free to bring a new action to further examine rates as soon as this order is final.

The Commission finds that the new adjustments proposed by the Company are not permitted by the terms of the Stipulation and are therefore rejected. The Commission finds that the updates proposed by the Division are not permitted by the terms of the Stipulation and are likewise rejected.

There exists one remaining dispute regarding the interpretation of the Stipulation, that being the treatment of the June interim rate reduction. On June 22, 1990, the Commission ordered that rates be reduced to achieve a revenue reduction of \$10,655,000 pending a final order establishing permanent rates in this proceeding. As implemented the interim reduction totalled \$10,711,000 effective June 22, 1990, for local exchange service, July 1, 1990, for 800 and OutWATS services, and July 18, 1990, for message toll and switched access services. In the Stipulation the parties have agreed to properly annualize and normalize 1990 actual revenues to reflect the realized \$10,711,000 revenue decrease on a prospective annual basis.

What is in dispute is the method by which the interim reduction is to be annualized. The Company interpreted the Stipulation to mean that the total \$10.7 million be removed from actual 1990 revenues as if the reduction had been in place for the entire year as shown in the Joint Exhibit attached to the Stipulation. The Division and the Committee interpreted the Stipulation to mean that the method of annualization should reflect the mid-year timing of the reduction and that the \$10.7 million shown in the Joint Exhibit was to illustrate the parties' agreement to the total reduction to be considered as the basis for annualization. In order to fully reflect the realized \$10,711,000 revenue reduction on a prospective, annualized basis as agreed to by the parties, the Commission finds that actual 1990 revenues need to be reduced by \$5,080,000 to account for the mid-year timing of the interim reduction and thereby remove the impact of the higher rates in effect only during the first half of 1990.

**B. DEPRECIATION**

On November 23, 1990, USWC submitted its triennial depreciation study to both the Federal Communications Commission (FCC) and this Commission. This study proposed changes in the projection-lives and future-net-salvage parameters previously approved by the Commission in 1988. In conjunction with the rate case and the Incentive Regulation Plan, the Commission requested that the Division review the study and report to the Commission with recommendations. Following its review of the study, the Division



conducted an audit and held discussions with USWC's corporate staff in Denver.

On January 18, 1991, USWC filed direct testimony and on February 5, 1990, rebuttal testimony detailing the depreciation rates for the three-year period January 1, 1991 through December 31, 1993. This study involved a detailed examination of historical data coupled with expert evaluation of the plans, trends, developments and other factors that impact on the future life expectancy of existing plant and equipment.

The Company, through witness Jerry D. Harris, testified that the depreciation study was prepared in conformance with extensive depreciation study guidelines established by the FCC. The study process required an extensive analysis of each depreciable plant account to determine the appropriate projection life, future net salvage and retirement curve shape which constituted depreciation rate parameters.

The Company proposed to increase its annual Utah intrastate depreciation expense by \$7,891,000.

The Division submitted its analysis of the depreciation study to the Commission through testimony filed by Division witness Larry Fuller. The Division recommended two alternative equipment life and depreciation expense proposals. The first alternative was based on "business as usual" absent the modernization proposal and would decrease intrastate depreciation expense by \$9,337,000 annually. The second alternative included changes that would be justified if the Commission approved the modernization plan with or

without an Incentive Regulation Plan. This alternative would result in a decrease in intrastate depreciation expense of \$4,441,000 annually.

The Committee filed testimony by Michael Arndt providing comments concerning USWC's 1991 Utah depreciation rate study and recommended a decrease in the annual intrastate depreciation expense of \$7,151,000 annually.

The Commission heard testimony on February 6, 1991 concerning the differences in equipment service lives and depreciation philosophies recommended by the different parties.

USWC stated that the purpose of depreciation is to recover the capital investment of the Company over the useful life of the investment and that such recovery is accomplished by the proper estimation of expected lives of the assets.

The Division stated that the first objective of the depreciation review is to establish depreciation rates based on Utah-specific evaluations of the projected service lives of the various existing equipment investment accounts. A secondary objective is to establish overall annual depreciation expenses that would help synchronize investment requirements for future equipment that will be replacing the existing equipment.

The Committee proposed that the depreciation rates the Commission approves be applied to the Company's average 1990 plant investment. Use of the 1990 average depreciable plant investment would produce the necessary matching of revenues, expenses and investment for the 1990 test year.

Considerable testimony on depreciation represcription was directed towards the correct interpretation of depreciation accounting. The Committee asserted that depreciation expense constitutes customer contributed capital. The Company argued and presented evidence that depreciation expense is an accounting mechanism to recover investors' funds for capital expenditures. The Commission agrees with the Company's definition of depreciation accounting. However, this Commission determines depreciation policy. In past decisions, the Commission has granted shorter asset lives and thereby increased depreciation expense. One result of this policy has been to protect the Company from the risks of technological obsolescence. Another has been to enhance the Company's positive cash flow thus enabling it to continue to expand and modernize the Utah infrastructure. The Commission finds that there is an implied relationship between its depreciation policy and its expectations for prudent and economic future investments.

The Commission finds that the Division's proposed depreciation parameters and associated depreciation rates consistent with the proposed Modernization Plan should be applied for the purpose of determining test year revenue requirement. Booking of the new depreciation expenses shall be ordered retroactively to January 1, 1991. In the future, the Commission will require the use of average plant balances for the purpose of computing depreciation expense.

C. COST OF CAPITAL

1. COST OF EQUITY CAPITAL

Witnesses for USWC, the Division, and the Committee presented equity cost of capital testimony in this docket. Testifying for USWC, Peter C. Cummings placed equity cost at 14.5 - 15.0 percent, and argued that a finding in favor of the incentive form of regulation necessitated the addition of 50 basis points or an equity return award at the high end of the range. A second company witness, Dr. Roger A. Morin, generally supported Mr. Cummings' position, but in final testimony estimated equity cost as 13.5 - 14.0 percent. Dr. George Compton, witness for the Division, gave a range of 11.1 - 11.6 percent as that within which the cost of equity might, depending upon the assumptions chosen, reasonably be found. The Committee's witness, Dr. Matityahu Marcus, related his estimate of equity cost directly to the capital structure used in the proceeding: 11.3 percent, if USWC's; 11.8 percent, if USW Inc.'s.

Witness Cummings developed his equity cost estimate by analyzing three groups of companies, which he selected to be comparable to USWC, using the Discounted Cash Flow (DCF) and the Capital Asset Pricing Model (CAPM) models. He argued in favor of the CAPM approach, and checked his results for reasonableness by comparing them with returns associated with the S & P 500 (slightly higher, as would be expected given a utility's lower risk), and with USW Inc.'s cost of new debt. Since the latter is approximately 10 percent, an equity return four to five percentage points higher is reasonable, he asserted. Moreover, issuance costs should be included

in the equity return award. Though he agreed that capital costs in general have declined since the last equity award, and even since direct testimony was filed in this docket, the witness argued that other relevant factors supported his higher estimate. His claim that incentive regulation, if adopted, would necessitate the addition of 50 basis points, owed to his conclusion that increased risk would be incurred by USWC (the result of the changed nature of regulation and the agreement by the Company not to seek rate increases). According to the witness, sole reliance should not be placed on the results of a DCF analysis because at the current time the technique uniformly gives results that are too low. One possible reason, he asserted, is the failure of current market price of common equity stock to adequately reflect the future value of USW Inc's cellular business. A key point in the witness's analysis is the use of nonregulated firms in samples of alleged comparability. This, he asserted, is a legal requirement arising under the Hope and Bluefield decisions of the U.S. Supreme Court. He did not dispute, however, that the return awarded in the last docket, 11.8 percent, had been sufficient to permit, as legally required under these decisions, the Company to raise capital at reasonable rates. The witness did acknowledge that the Company is close to 100 percent internally financed, owing largely to depreciation and deferred tax sources. He also acknowledged that USWC has lower risk than its parent, USW Inc.

The second rate of return witness for the Company, Dr. Morin, asserted that several methods, and not simply the DCF, must be used to estimate equity cost. Thus, he applied risk premium, CAPM,

and DCF methods to sample companies. A particular point he made was the difficulty of estimating the dividend growth rate, the variable 'g' in the DCF formula at moments, such as the present, of unusual economic conditions. According to the witness, the DCF may under- or over-estimate the cost of capital when interest rates are moving strongly; hence, its results should be evaluated in the context of other models' results. When the results from several models cluster closely around a particular value, a good indication of equity cost is obtained; but when, as in this case, the results of DCF applications are at variance, he asserted, the analyst should question whether the model's assumptions adequately reflect current conditions. They do not, he contended. Emerging competition and a tendency toward deregulation are putting telecommunication utilities in a different risk category than electric and natural gas utilities, he stated, making them more like industrials generally. He agreed with Mr. Cummings that USWC is a less risky entity than its parent, USW Inc., however. Sample firms to be used to estimate equity cost for the utility must be selected on the basis of comparable risk, and for this purpose no single measure of risk is alone sufficient, according to the witness. Selection of sample firms is therefore a difficult analytical task, but this is no reason simply to rely on telecommunication companies--the seven regional holding companies--alone, he said. Doing so is defective analysis owing to inherent circularity of reasoning involved, according to Dr. Morin. Because of this and his assertion that utilities are now more like industrials as to characteristics of risk, Dr. Morin based his equity

cost estimate on a sample composed equally of regional holding companies and industrials.

Dr. Compton, witness for the Division, stressed the point that all evidence showed a decline in capital costs since the last rate case. Based on his analysis, a return on equity award in this docket should not be higher than the 11.8 percent currently allowed, the range of reasonable estimates now being 11.1 - 11.6 percent. His explanation for why this is 300 and more basis points below Company witnesses' recommendations lies generally in the degree of emphasis placed upon the DCF model and the analysis of risk supporting choice of comparable firms. Dr. Compton stated that comparability of risk is indicated by similarity of results obtained from DCF analysis, and questioned the wisdom of relying on the risk measure 'beta' as company witnesses had done. He indicated the role played by beta in portfolio analysis, distinguishing this from the task of selecting comparable firms for rate of return estimation. The witness supported inclusion of flotation costs in theory and, as to the appropriate version of the DCF model to use, supported one that incorporates the quarterly dividend adjustment. He did not, however, alter his final recommendation to account for either of these because, in his opinion, they were offset by other factors.

Testifying for the Committee, Dr. Marcus directly related his equity cost recommendation to capital structure, arguing that USWC is less risky than its parent, USW Inc., as is its capital structure. Thus, if USWC's capital structure is employed, the proper equity return is 11.3 percent, he stated, whereas, if the capital

structure is to be the parent's, equity return should be 11.8. His recommendation is that USWC's capital structure and equity return are what is at issue in this proceeding and, since both can be estimated adequately, they are what should be considered. Hence, the appropriate equity award is 11.3 percent. Dr. Marcus employed the DCF model and argued this is appropriate for a company like USW, which is one of the 50 largest in the U.S., is a stable entity because the bulk of its revenues is from telecommunications operations, and is continuously analyzed by at least a dozen security analysts. It is the sort of company for which there are no directly comparable firms, he stated. In fact, owing to the points enumerated, direct observation is appropriate; there is no compelling need to seek proxies, he testified. Comparable companies cannot be selected on the basis of a single risk measure like beta, as Company witnesses had done, in any event, according to Dr. Marcus. Other risk measures, including those employed by Dr. Morin, give different results, thus requiring the exercise of judgment by the witness. He argued beta is unreliable if used to select comparable firms. In particular, the beta indication that telecommunications utilities are riskier than natural gas and electric utilities, as asserted by Dr. Morin on the basis largely of his beta analysis, cannot stand, said Dr. Marcus. He asserted, moreover, that the difference between regulated utilities and unregulated industrials is a critical one that cannot be ignored in the selection of comparable firms. Dr. Marcus did not support inclusion of issuance costs in an equity return award for this company because the Company issues stock at



prices well above book value, benefitting existing shareholders by an amount greater than such costs might be. Regulators set return based on book value, he stated, and book value had gone up. Moreover, the facts alone do not justify allowance for issuance costs, according to the witness, if only because such costs apply to the sale of common equity in the market. The Company, by contrast, can finance internally, and, as a supporting point, no evidence shows such costs were transferred to USWC at divestiture. Nothing at this time suggests the DCF model cannot be relied upon, he averred, and arguments to the contrary are misleading if based on the notion that things are in flux, for in fact, things are always in flux. There is also evidence for the proposition that the DCF may now be overvaluing equity cost, given Company witnesses' testimony that the market may be undervaluing stock price. This is at least as credible as these witnesses' assertion that the DCF-determined equity cost is too low, according to Dr. Marcus.

The Commission believes it necessary to estimate the costs of equity of USWC, the regulated utility, not USW Inc., the parent corporation, though analysts may focus on USW Inc. as the entity which issues common stock. All witnesses agree that USWC is not as risky as USW Inc., and this fact, considered alone, argues for an equity award lower than would be indicated by an analysis of USW. Dr. Marcus, for example, quantifies this risk difference at 50 basis points.

When the DCF analysis is performed consistently and in line with our discussions and decisions in recent orders, it becomes

difficult to argue for an equity award much above the existing 11.8 percent arises. There is no ambiguity about the fact that, throughout the economy, since the last USWC rate case, capital costs have trended downward. This trend has meant that all witnesses reduced their recommendations between the filing of direct testimony and the close of the hearing, a short time later. Nor does this case, in spite of the efforts of Company witnesses, produce new evidence or persuasive argument to convince us to revise our negative views of the capital asset pricing model and risk premium approaches to estimation of equity cost. Moreover, the Company's argument that reliance on a DCF analysis to estimate the cost of equity must produce, under current circumstances in the industry and economy, an unreasonable result, fails on this record. This is the case principally because their analysis of comparable companies was not convincing. The determination of risk similarity, which is the heart of the approach, was not adequate.

Were this a complete summary of our conclusions, a return award at, or, more probably, below the current allowed return would be inescapable. But the fact is, near term conditions in the industry and the economy are quite unsettled. We have on this record, for example, expert witness opinions that are diametrically opposed. Company witnesses have argued that the DCF underestimates equity cost because the model cannot be relied upon during times of strong interest rate movement and because the market has not yet properly valued the future potential of a present Company position in cellular. The Committee witness, on the other hand, testified that

the DCF might be producing a cost of equity estimate that is too high, if the opinion of Company executives that the market currently undervalues USW's common stock is reliable.

Expert witness disagreement is not unusual. But where performance of common stock in the market is so critical to the analysis, the lack of agreement as to future direction--not magnitude--of change is notable. This difference of opinion seems rooted in appraisals of general conditions in the economy; that is, where things now stand in relation to the business cycle, and how the market price of USW Inc.'s common stock can be expected to move with respect to it. These appraisals are decidedly different. The Commission is aware that utility stock price movements bear a relationship to interest rate changes. Should interest rates go up in the near future, as may be the case if the attention of policy makers shifts from recession to inflation, the market price of utility common stock, other things being equal, would tend to fall and the cost of equity to rise.

Too much should not be made of such speculation, not least because no coherent form of it appears on the record--though it is generally acknowledged that utility common stock prices and interest rates vary inversely. The testimony of Company witnesses stands for the proposition that this relationship is weakening as telecommunications firms begin to look more like industrials. But their point is disputed. It does, however, focus attention, and quite properly, on uncertainty, the basic problem a cost of capital witness must confront. Any model employed has its principal value in

providing a structure by which uncertainty can be managed. This value derives mainly from a consensus among experts that the model is useful and produces results that can be relied upon. For example, in the DCF, the growth component, 'g', cannot be known with certainty, but the model gives an acceptable way of estimating it. The DCF permits an evaluation of market price on the basis of the future flow of dividends and the investors' required rate of return (estimated, of course); the problem of estimating 'g' is to infer what growth rate in dividends is currently being expected by investors. But by one technique of analysis or another, each model permits its user to grapple with the uncertainty of the future, and to do so in ways that have been found acceptable.

The Commission's task is to estimate the investors' required rate of return. The models used by witnesses present a range of estimates of the cost of equity capital. Required rate of return and cost of equity capital may differ for several reasons, including the allowance of flotation costs, adjustments for management performance, and other factors. In this docket, the Commission finds the required return exceeds the cost of capital estimate produced by mechanical application of the DCF model.

Estimating investors' required return is an exercise of informed judgment. At its heart, the problem is placed in an uncertain future, where many things, both known and unknown, affect outcomes. The problem is complex and subtle. Mathematical models are a guide and a framework for thinking about the problem, but are no substitute for the exercise of informed judgment. Unqualified

reliance on model results would be misplaced. For example, it is easily shown on the record in this docket that the DCF may, under present circumstances, both over- and underestimate equity cost. Even so, the Commission regards it as more reliable than the CAPM and risk premium approaches, but acknowledges the effort of Company witnesses to discredit the DCF and to elevate CAPM and risk premium.

The key to the return on equity decision is an award which adequately compensates investors for willingness to bear risk. Our knowledge of the determinants of, measurement of, and implications of risk assessment, is, on this record, incomplete. Part of the reason is to be found in the nature of the problem, as discussed previously, and part in the failure of the record to contain a complete and coherent examination. The record, instead, contains expert testimony on various aspects of risk in relation to return, but only disputes on how well it has been measured. This is particularly evident in the comparable firms entanglement. A sample of firms selected on the basis of one risk measure, such as beta, is unreasonable, and the more so where other allegedly supplemental measures the analyst may have employed seem to confound choice rather than to clarify it. The Commission finds that no single measure of risk can be sufficient to establish the risk comparability of firms.

The U.S. Supreme Court decisions, Hope and Bluefield, cited by witnesses cannot reasonably be read to require comparison of a regulated utility with non-regulated firms. These entities are so unlike one another that, whatever the merit of attempting to escape circular reasoning, the difficulties in establishing risk

comparability have not been overcome on this record. The Commission finds that this task has not been accomplished, and, were it a straightforward requirement of the Court, as Company witnesses seem to assert, no decision could be made unless the record were supplemented. This, the Commission rejects. On one point, however, the record is clear. Attraction of capital under reasonable terms is a test articulated by these Court decisions. A return on equity decision must be compatible with it. Evidence is uncontroverted that the Company has been able to attract capital favorably with the 11.8 percent return on equity awarded in the previous docket.

Through testimony, USWC has attempted to liken itself to an unregulated company, loosely fitting the market's 'industrials' category. This effort has failed. The Commission draws this conclusion even though recognizing that the telecommunications industry is changing in significant ways. Such changes have yet to disturb the essential characteristics of USWC as a regulated provider of essential services in this jurisdiction: the well known aspects of a monopoly position in the relevant market, the trust relationship between utility and consumers, and the imposed constraints upon both prices charged for services and rate of return. As conditions change, the Commission may, in future dockets, conclude otherwise.

Without dispute, capital costs have declined since the previous rate of return decision of 11.8 percent, and even since the filing of direct testimony. Taken alone, this would argue for reduction in allowed return. But other compelling factors have a role to play. The record on risk-return comparability, while not

complete, on balance suggesting increasing risk; the questioned reliability of model results during unsettled moments in the economy and industry; the large, even contrary, difference in results obtained by witnesses for the Company compared with witness Compton for the Division using CAPM; the knowledge that the utility may to a degree be shedding certain utility characteristics; and the ambiguous record on expected behavior of stock price, are all influential considerations which must be evaluated in the context of a wide range of cost of equity results obtained by witness application of models. The Commission concludes there is no reason to grant an award at the upper end of the range, and indeed there are reasons why this would be error. The Commission is convinced a reduction in the current equity return, though advocated by witnesses for the Committee and the Division, would likewise be in error, given the risk implications of the changing industry and the status of the general economy in relation thereto.

The Company repeatedly stressed that its discretionary investment decisions are driven by profitability considerations, meaning in part that economic analysis, or business case analysis, is employed to rank alternatives. Implied at times and explicit at times was the message that jurisdictional rate of return allowed by commissions could be the determining factor. The rate of return on equity in Utah is 11.8 per cent, the lowest in the 14-state USWC service territory. The Company's witnesses labeled that rate unreasonable and made the connection between it and discretionary investment aimed for the state.

It is the fact that the earned rate of return on equity, as distinct from what is allowed, in Utah is among the highest in the 14 states, and has been so in recent years. The Company, however, argued that expected rate of return, based on allowed not past actual rate of return, is what is related to investment decisions. Nevertheless, the Commission notes that in the recent past when the allowed rate of return in Utah was among the highest, no discernably different pattern of discretionary investment decisions affecting Utah appeared. The Commission concludes that historical evidence does not reveal a clear relationship between either allowed or earned rate of return on equity on the one hand and the amount of discretionary investment in the state on the other.

Nevertheless, the Commission acknowledges the logic of the relationship between rate of return and investment decisionmaking. Regulation presumes a reasonable management. This is a time when states are in a sense competing for high-tech additions to and refinements of telecommunications plant and equipment. The Commission concludes that it is prudent to take these considerations into account when determining rate of return. Together, they argue for an addition to the cost of capital estimate produced by models.

The Commission is concerned enough with the factors enumerated in the discussion to raise the allowed return on equity capital to 12.2 percent from the existing 11.8, and finds this return to be reasonable.



## 2. CAPITAL STRUCTURE

Because debt is cheaper than equity, and interest expense on debt is tax deductible, the higher the debt ratio, other things being equal, the lower the cost of capital. The trade off is that increases in the debt ratio increase financial risk. It could be said that management should employ as much debt as is prudent, given this trade off, while regulators must be sure that too much equity is not employed in order to prevent an increase in the cost of capital that could be harmful to ratepayers. Company witnesses argued that because business risk is increasing, the debt ratio must be decreased in order to maintain bond ratings. A lower debt ratio decreases financial risk, maintains bond rating and protects shareholders. But the lower debt (higher equity) ratio costs ratepayers more, other things being equal, by increasing the cost of capital. This appears on this record to be true even though a higher bond rating reduces the cost of financing. Clearly, at least in principle, there is a financially prudent capital structure which could be employed for ratemaking purposes that would yield the lowest cost for ratepayers.

The proper composition of the capital structure for ratemaking purposes is one issue before the Commission in this docket. A related issue, whether to use USWC's or USW Inc's capital structure, captured equally as much attention. Neither is hypothetical, but the equity return recommendations may vary according to the choice since financial risk differs.

As pointed out in previous discussion, all witnesses acknowledged that USWC is a less risky entity than USW (lower business risk). Moreover, USW's capital structure risk (financial risk) is greater. The equity ratio is 60.4 percent for USWC, while for USW it is 48.2 percent. Company witnesses argued in favor of employing USWC's capital structure to determine overall cost of capital. A strong capital structure--more equity, in adverse times assures an acceptable bond rating (preferably AA), thus protecting both shareholder and ratepayer interests, they stated. Company witness Morin also argued that the equity ratio advocated by the Company is similar to that of peer companies; otherwise he would recommend use of a hypothetical capital structure. Committee witness Marcus testified that the variation in equity ratios between the two structures had not existed in previous rate cases, when in fact the ratios had been almost the same. He speculated that the divergence might be a transitional phenomenon, which should, with Commission encouragement (a lower equity award), disappear. Witness Marcus urged the Commission to be aware of the parent company's ability to control the amount of equity in the capital structure of USWC, a wholly owned subsidiary. Witness Compton generally supported use of USWC's capital structure, asserting that an equity ratio of approximately 60 percent is not unexpectedly high. He noted that a hypothetical structure with 55 percent equity would be acceptable and called attention to the lack of preferred stock in the capital structure though it is usually found in that of the energy utilities. In total the equity share may only appear high, and, therefore, Dr.

Compton supported maintenance of a AA bond rating, which he associated with the higher equity ratio.

No witness advanced a hypothetical capital structure in this docket. Each was confident that an actual capital structure, either USWC's or USW Inc.'s, could, with justification, be employed. In this case, the Commission finds that the weight of the evidence supports a higher equity ratio found in the USWC capital structure. As with the equity award decision, there are compelling arguments that this is an unsettled time, that business risk may be increasing, and that bond ratings may be jeopardized by a low equity ratio. All witnesses supported use of USWC's capital structure for determination of the overall rate of return. Witness Marcus, however, did tie his recommended equity return to the capital structure--11.3 percent if USWC's; 11.8, if USW Inc.'s--to alert management that the Commission should tolerate a divergence in the two capital structures only for a short period of time. The Commission finds that USWC's capital structure, composed of 60.4 percent equity and 39.6 percent debt, is reasonable for purposes of determining the overall rate of return to be granted in this docket. At the allowed equity return of 12.2 percent, this produces an allowed overall rate of return of 10.93 percent.

D. SUMMARY

The actual 1990 intrastate results of operations as well as the positions of the parties with respect to the determination of revenue requirement are summarized and presented in

Table 1 below. The unadjusted actual 1990 results excluding imputed directory revenues show the Company earned a rate of return on equity equal to 13.35 percent, exceeding the 11.80 percent allowed rate of return on equity used to establish the rates in effect during 1990.

The Company's interpretation of the October Stipulation and its recommended adjustment to depreciation expenses had the effect of reducing the rate of return on equity expected to be earned during the test period to 11.33 percent. Given its recommended 13.5 percent allowed rate of return on equity, the Company had proposed to increase revenues by \$9,804,000.

The effect of the Division's and the Committee's adjustments was to raise the rate of return on equity expected to be earned in the test period to 16.57 percent and 17.19 percent, respectively. Given an 11.35 percent allowed rate of return on equity, the midpoint of the range recommended by Division witness Compton, the Division had proposed to decrease revenues by \$23,434,000. Given an 11.30 percent allowed rate of return on equity, recommended by Committee witness Marcus for the US West Communications capital structure, the Committee had proposed to decrease revenues by \$26,527,000.

The Commission's findings with respect to the Stipulation and adjustment to depreciation expenses result in increasing to 16.58 percent the rate of return expected to be earned in the test period. Given the Commission finding of a 12.20 percent allowed rate of return on equity, the Commission finds that revenues should be reduced by \$19,799,000.

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**TABLE 1**  
**REVENUE REQUIREMENT**  
 Summary of the Positions of the Parties  
 and Commission Decision  
 1990 Utah Intrastate Results of Operations  
 Test Period (\$000)

	1990 Actual (Excl. Directory Revenues)	Company	Division	Committee	Commission
1. Total Operating Revenue	315,736	313,637	320,069	319,268	319,268
2. Total Operating Expense	252,016	253,143	240,675	237,491	240,199
3. Total Income Taxes	10,427	12,172	17,001	16,752	15,742
4. Other Income	-135	51	200	-463	-463
5. RATEMAKING INCOME	53,158	48,373	62,593	64,564	62,864
6. RATE BASE	457,107	464,890	461,673	463,126	463,126
7. Earned Rate of Return on Rate Base	11.63%	10.41%	13.56%	13.94%	13.57%
8. Earned Rate of Return on Equity	13.35%	11.33%	16.54%	17.18%	16.57%
9. Allowed Rate of Return on Equity	11.80%	13.50%	11.35%	11.30%	12.20%
10. Allowed Rate of Return on Rate Base	10.69%	11.71%	10.41%	10.38%	10.93%
11. Recommended Change in Revenues		\$9,804	(\$23,434)	(\$26,527)	(\$19,799)

Absent the two interim rate decreases of this docket, revenues in the test period would be \$338,217,000. With the June 22, 1990 interim reduction of \$10,711,000, the January 1, 1991 interim reduction of \$8,238,000, and the final decrease of \$19,799,000, test period revenues will have been decreased by a total of \$38,748,000 to \$299,469,000, representing an 11.4 percent decrease in prospective rates as a result of this docket. The Commission also notes the 1990 test period revenue requirement is about 6 percent lower than the

1988 test period revenue requirement of \$319,047,000 found in Docket No. 88-049-07, despite the growth in access lines and minutes of use during that period.

III. DISCUSSION, FINDINGS, AND CONCLUSIONS WITH RESPECT TO REVENUE SPREAD AND RATE DESIGN

A. COST-OF-SERVICE

1. BACKGROUND AND OVERVIEW

Since divestiture in 1984, the Commission has accorded a rising priority to cost-of-service studies in ratemaking decisions. There have been three general rate cases since divestiture, Docket Nos. 84-049-01, 85-049-02 and 88-049-07. In both Docket Nos. 84-049-01 and 85-049-02, the Commission stated that the relationship between cost incurrence and service provision was inadequately explored and the respective records were inadequate for pricing decisions. As a consequence, the Division was requested to provide the Commission with telephone cost-of-service studies.

In Docket No. 88-049-07, the Division submitted its cost-of-service model, termed DCOS, for its first review by the Commission. DCOS was created over a two-year period from the Company's 1987 prototype Management Marketing Information System cost-of-service model, termed MMIS. The DCOS model and disputes concerning its study methods were described on pages 89-111 of the Report and Order issued October 18, 1989 in Docket No. 88-049-07.

As a result of the Commission's review of the initial DCOS model, the Company and the Division were ordered in Docket No.

section. All of these changes will be displayed in a final table to be attached to this Report and Order.

#### IV. NETWORK MODERNIZATION

##### A. INTRODUCTION

In this case the Company has submitted a proposal for modernization of its network in conjunction with its incentive regulation plan. According to Company witness Phillip S. Selander, the proposed modernization investments will be "a beginning or seed for the network of the future [and] they will give us the fiber optic and digital building blocks from which we can expand." The modernization plan would accelerate the installation of new central office switching and interoffice facilities in order to support the wide variety of capabilities and services that the network of the future may require. Thus, Company witnesses testified that the modernization plan is an important investment in Utah's future.

##### B. DESCRIPTION OF THE PLAN

The modernization plan, as presented by the Company, is primarily aimed at upgrading rural central offices and laying a fiber optic network to facilitate telecommunications for educational, governmental and hospital use as well as for residential and business customers. This would permit high-speed, high-capacity data transfer and accommodate two-way video transmissions in support, for example, of "distance learning." The upgrade would improve service for rural customers, the Company stated.

The modernization plan the Company originally filed on March 2, 1990, called for \$103 million in additional capital to be invested in Utah. \$52.46 million of the investment is for the replacement of 46 electro-mechanical central office switching equipment with digital switching equipment and the remaining \$51.67 million is for new interexchange fiber optic cable. When in place, according to the Company, high capacity transmission would exist from Brigham City to Cedar City, with digital radio extensions to Logan, Price, St. George and Vernal. The plan also included the construction of local fiber networks to connect central offices to universities, colleges and high schools. The Company stated that all projects would be completed within 54 months from the date of the Commission's order in this docket.

The Company's proposed plan was revised in response to testimony by the Division and the Committee, and by the Company's conclusion that five of the central offices in the original plan and transmission from Brigham City to Logan would hit "hard triggers", i.e., growth would exhaust capacity, requiring an immediate upgrade in order to maintain service. The Company's witnesses Robert C. Fuehr, Kirk R. Nelson, and Phillip S. Selander, in later filings and oral testimony, described the Company's revised modernization proposal. The revised plan proposed an upgrade to digital technology of the 41 remaining electro-mechanical central offices. The central office upgrade and facility augmentations needed to support such upgrades to digital technology were estimated to cost \$36.35 million on a total state basis and \$25.76 million on an intrastate basis, over a five-year period.



The second part of the revised plan is an expansion of the fiber optic and digital infrastructure "backbone" so that it runs from Logan to St. George, with upgraded digital microwave extensions to Vernal and Price. The Company consented to the Division's recommendation that the fiber optic extensions in support of higher education and distance learning, i.e. local fiber optic loops from central offices to every college, university and high school, would be installed only when economical. The estimated capital cost of the fiber extension is \$21.5 million. The commitment to lay fiber cable to all colleges, universities and high schools and school district offices when economical requires the investment of \$33.88 million in discretionary capital.

#### C. BENEFITS OF MODERNIZATION

All parties to this case agree that there are substantial benefits to be gained from modernization in general and the Company's proposed modernization plan in particular. Mr. Fuehr testified that "communications will become an even more critical link than it is today in the economic well-being and development of a highly mobile and technical society.... Telecommunications will play [a role] in enhancing the global competitiveness of Utah businesses." Company witness Dr. Davidson testified that in order to remain economically competitive, states would have to upgrade their telecommunication networks. He alerted the Commission to the consequences of inadequate investments in new technology: "Without modernization to provide higher quality, lower cost and advanced services, the gap between public and private offerings will widen, sophisticated users will shift increasingly to private networks and the remaining users

will find it difficult to secure basic and enhanced services at reasonable rates.... The ultimate impact of inadequate public telecommunications capacity on local economic and social conditions remains to be seen, but it could place selected regions and segments of society at a distinct disadvantage."

Company witness Selander stated that educational needs alone technically would justify the proposed enhancements, but when combined with government and research needs, the modernization project is even more economically feasible. The enhancements in the digital infrastructure would allow the system to carry a wider variety and greater quantity of traffic more economically. According to the Company, its new capabilities would include distance learning, a higher education library network, and a research network connecting universities, colleges and businesses to a centrally-located super computer. Utah State University's ComNet and the state government's digital communications requirements could be met. The Company testified that the increase in telecommunications services would promote economic development in general and rural development in particular.

A number of public witnesses testified in favor of fiber optic extensions to colleges, universities and high schools in support of distance learning. Mr. Steven Hess, Director of the Utah Educational Network, testified that it was his organization's goal to extend its distance learning service to every rural high school and applied technology center in need of the service, within the next five years. He further testified that the extension of fiber to those facilities would provide the capacity needed for such expansion. Dr. Bartell C. Jensen, Vice President for Research at Utah State University (USU)

and Dr. Glenn R. Wilde, Executive Director of the Merrill Library and Electronic Distance Education at USU, testified that the communications network proposed by U S WEST would provide the capabilities of two-way interactive video at community sites, schools and colleges and universities in the state. They further testified that the proposed U S WEST network would provide a critical and needed backbone service to make a statewide educational and training system workable. Mr. Will Gardner of BYU, and Chairman of UTAHNET, a Task force chartered by the Utah State Advisory Council for Science and Technology to study the needs for high capacity telecommunications in Utah, testified that upgrading the telecommunications infrastructure to reach schools (especially in the rural areas) with interactive television capabilities would be the single most effective way to upgrade the educational posture of the entire state.

In addition, the Commission has received many letters from educators, community leaders and concerned citizens in support of the modernization proposal.

The Company, the Division and the Committee offered testimony that the proposed central office upgrades would make enhanced services and capabilities available to all USWC's customers, including rural customers presently unable to obtain such services as equal access to interexchange carriers and such custom calling features as call waiting, call forwarding, speed calling, and 3-way calling. In addition, the upgrades will provide for more accurate and clearer transmission of voice and data. Further, the upgrade will allow the offering of additional CLASS services when the Company begins to market them in the state.

The Commission finds that the central office upgrades will provide more accurate processing of dialed digits, faster touch tone services, faster call completion, clearer conversations and more accurate data transmissions. The Commission further finds that the modernization plan will enable USWC to provide new services that are not currently available in Utah. In addition, the Commission finds that the proposed investments would be of benefit to and would meet a wide variety of residential, business, educational, governmental and research needs, and concludes that the Company's proposed modernization program is clearly in the public interest.

D. RISKS OF MODERNIZATION

The Company maintained that the proposed investments contained in its modernization plan, and in particular the investments in upgrading central offices, were discretionary and would not be made in a business-as-usual environment. These investments, although yielding benefits to the state and its citizens, might get subordinated to other investment opportunities. The Company maintained that modernization investments, while providing net benefits, are riskier in that the expected earnings received by USWC are less than the expected earnings on other possible investments. The Company claimed that only the opportunity to earn higher profits through a change in regulatory form would induce it to carry the additional risks of modernization investments. USWC maintained that the modernization plan is a good faith effort to demonstrate its intent to further its investment in Utah. The Company believes that by making investments that have high social benefits but low internal

rates of return to the Company, it demonstrates its commitment to the public interest.

The Company also argued that discretionary modernization investments can be risky in that they may not be incorporated into rate base. If the regulatory body determines that an investment is not prudent, then the shareholder must bear its cost. The Division pointed out that in the recent past there has not been a case where a major USWC investment had been excluded from rate base and, therefore, the risk to the Company is minimal. It contended that an understanding of this Commission's regulatory treatment of the Company's past investments is necessary to any analysis of the regulatory risk of a particular future investment.

The Company asserts that it may turn out that the demand for high capacity transmission is limited at present causing the revenues generated to be insufficient to fully cover costs. But the testimony of the other major parties was to the effect that if the investment is included in rate base, rates will be set to recover the costs, and thus the Company will be protected.

Both the Division and the Committee testified that most of the central offices included in the modernization plan are scheduled to be replaced by 1996 in the Company's business-as-usual budget. Thus, the plan would accelerate already planned investment by just a few years.

The Commission finds there is substantial evidence on the record that the modernization investments will benefit Utah in the near and long term future and are, therefore, a prudent risk for ratepayers.

There was considerable testimony on the record by the Division and the Committee asserting that depreciation policies adopted by the Commission have provided the Company the opportunity for rapid recovery of investment. The Company therefore has the ability to respond to rapid changes in technological innovation and emerging new, specialized customer demands without undue rate shocks to the general body of ratepayers. The Commission finds that the Commission has protected the Company's recovery of investment by adopting liberal depreciation policies.

Company witness Dr. William H. Davidson warned the Commission that it should not prescribe by order additional investment in the state of Utah. Any such effort could be circumvented by a reduction of investment elsewhere in the state. This could degenerate, he argued, into a situation where the Commission is forced to micro-manage the Company and thus assume responsibility for the investment decisions of the Company. The Commission ought not to have any desire for such a role. According to Dr. Davidson, the principal way to increase investment in Utah is to increase the rate of return on investments. He testified that the incentive plan is the most efficient way to raise the rate of return.

The Commission admonishes the Company against compensatory decreases in investment in other areas. There is evidence on the record of the Company's planned investment for the state absent an incentive plan. The Commission does not wish to see any gross deviations from those plans. USWC's investments in the state must insure a high quality of service as determined by this Commission. Appropriate regulatory measures will be taken to insure such quality of service. USWC possesses a certificate of convenience and

necessity and franchises to provide essential public services throughout its service territory. The Commission finds that the Company has the obligation to provide such services, determined by this Commission, so long as it holds that authority.

The Company also contended that its modernization plan in conjunction with the incentive plan increases its risk exposure. Such risk raises shareholders' required rate of return and therefore should be reflected in the incentive plan. Thus, the Company argued in favor of a gap between the authorized rate of return and that above which a sharing of earnings with ratepayers would commence. The Company maintained that it is at risk if the cost of capital increases. The Commission finds that such risk is attendant to the incentive plan alone and should not affect any decision on modernization. The Commission finds that neither the Company nor the ratepayer bears inordinate risk in modernizing the remaining electromechanical central offices, extending its digital "backbone" infrastructure, or the fiber optic extensions as contemplated by the Company's proposed modernization plan.

#### E. COMMISSION AUTHORITY

The Company has persuasively argued that the benefits of rural upgrade and modernization are substantial and those benefits are detailed herein and throughout this record. All parties are agreed that the public interest would be served by the modernization program proposed by the Company. At issue is the Company's insistence that the program is uneconomical without a change in regulatory framework as it has proposed in its incentive plan and that the Commission is

without authority to order modernization unless the Commission finds that the upgrades will be economical.

As clearly stated above, we do not agree that we must make such a finding. Nonetheless, we are of the view that the program may on the whole be economical. The Company submitted three studies on the economics of modernizing the central offices using its Capital Utilization Criteria (CUCRIT) model. The first study was submitted in response to the Committee's interrogatories concerning modernization. This response used data from a 1988 study on the then 54 remaining electro-mechanical central offices in the state. The study narrowed its analysis to the originally proposed 46 offices and concluded that modernization of these offices as a whole was uneconomic. However, as pointed out in the Committee's testimony, the study excluded the additional revenues that would be generated by the new services available from the upgraded offices. The Company updated this study by including these additional revenues and excluding five central offices that had reached "hard triggers". This study indicated that three of the central office upgrades were economical, 19 were marginally economical and 19 were uneconomical. Taken as a complete package, the investment was deemed by the Company to be marginally economical.

Mr. Fuehr ordered a new CUCRIT study in December of 1990 and late-filed with the Commission on February 13, 1991. This study examined the economics of the 41 central offices that were included in the revised modernization plan. It concluded that such modernization was uneconomic. Because this study was late filed, however, the parties could not adequately assess it. Therefore, the Commission cannot rely on it to make a finding. In addition, there



is no formal analysis on the record concerning the economics of the fiber optic backbone and central office interties.

In sum, the evidence purporting to show the Commission that the modernization program is uneconomical is not persuasive. The Commission finds that the Company's studies are not conclusive and may not include all of the benefits identified on the record, and therefore the Commission cannot conclude that the proposed central office modernization is uneconomical.

The Company cites two cases, the Mulcahy case (Mulcahy v. PSC, 117 P.2d 298, 1941) and the Lifeline case (Mountain States Telephone v. PSC, 1988) in support of its position that the Commission cannot order the Company to make expenditures which are uneconomical. Neither of those cases is convincing. The Mulcahy case is a trucking case in which the Commission was required to determine whether or not to grant a trucking company an operating certificate over opposition from an already certificated carrier for the same territory. In dictum the Court discusses the criteria for determining whether public convenience dictates that a new carrier be certificated in the territory and refers to the need to have the patronage for the service to justify the expense of rendering the service. That fact situation is completely different from the one facing the Commission here. In this case the Commission is considering the advisability of having a regulated utility upgrade its service. There is no debating whether or not another phone company should be granted a certificate in USWC's existing service territory. Clearly, the criteria for the entry of a competitor into an existing utility's service territory would be different and more stringent than the criteria for requiring an existing utility to upgrade its service. It is not unreasonable

in the Mulcahy case, as opposed to this one, that the Court should require that the would-be competitor's rates be cost-justified so as not to be predatory.

The Lifeline case stands for the proposition that the Commission lacks a specific delegation of legislative authority to have the customers of one utility in this state bear some of the cost of a program for the customers of another utility in this state.

This present case is not dealing with separate utilities--it is dealing only with USWC. The issue is whether or not the Company should be required to provide upgraded service for its own customers, not the customers of another utility. In the Lifeline case the Court determined that the Commission lacked a legislative delegation of authority to direct the Company to surcharge its customers for a statewide pool of Lifeline program funds that would be used for the customers of all phone companies. That has nothing to do with the Commission's authority to order an upgrade in the utility service offered by a utility to its customers. These are apple and orange issues.

There are multiple statutory references to the Commission's authority to require adequate service which supplement the Commission's general jurisdictional grant at 54-4-1:

The commission is hereby vested with power and jurisdiction to supervise and regulate every public utility in this state, and to supervise all of the business of every such public utility in this state, and to do all things, whether herein specifically designated or in addition thereto, which are necessary or convenient in the exercise of such power and jurisdiction.

The first of these is 54-4-7, which is a clear and plain statement of the Commission's authority to regulate and supervise the

services and commodities provided by utilities and order changes where present services are no longer adequate.

Whenever the commission shall find, after a hearing, that the rules, regulations, practices, equipment, appliances, facilities, or service of any public utility, or the methods of manufacture, distribution, transmission, storage or supply employed by it, are unjust, unreasonable, unsafe, improper, inadequate or insufficient, the commission shall determine the just, reasonable, safe, proper, adequate or sufficient rules, regulations, practices, equipment, appliances, facilities, service or methods to be observed, furnished, constructed, enforced or employed, and shall fix the same by its order, rule or regulation.

Section 54-4-8 is in the same vein.

Whenever the commission shall find that additions, extensions, repairs or improvements to or changes in the existing plant, equipment, apparatus, facilities or other physical property of any public utility or of any two or more public utilities ought reasonably to be made, or that a new structure or structures ought to be erected to promote the security or convenience of its employees or the public or in any way to secure adequate service or facilities, the commission shall make and serve an order directing that such additions, extensions, repairs, improvements or changes be made on such structure or structures be erected in the manner and within the time specified in said order.

Section 54-8b-11 charges the Commission with making available to customers throughout the state high-quality, universal telecommunications services. Section 54-3-1 requires that utilities provide equipment and service which promotes the safety, health, comfort and convenience of its customers.

The adequacy and convenience of service and equipment can change over time. Operator-switched calls and multi-party lines were once considered adequate; obviously, they no longer are. The Company itself has admitted on this record that the simple ability to complete a call in today's environment does not constitute adequate service. The Commission finds that service to certain customer areas

is not adequate by present day standards and that the modernization program is necessary at this time to provide all customers in this state with adequate and convenient service. It is, therefore, in the public interest. We conclude that it is for this Commission to determine what is necessary and convenient in the way of utility services, require the utility to provide it and allow that provider an opportunity to earn a fair return on its investment.

F. SUMMARY

The Commission recognizes that telecommunications provides beneficial externalities. A modern telecommunications infrastructure permits the efficient and economical flow of information, to the benefit of consumers of all sorts. As a result, it also may promote economic development.

Prudent and properly timed modernization is an important requirement facing the telecommunications industry. Therefore, it is a necessary element of good regulatory policy to promote economic and timely modernization. This Commission will encourage timely, socially beneficial investments, and will allocate corresponding costs fairly and equitably.

The Commission has found that the public interest requires the Company to undertake its modernization plan, whether or not its proposed incentive plan is approved. USWC will have the opportunity to earn its allowed rate of return on the proposed modernization investments and, therefore, will be compensated for the risk of such investment.

The Company must not provide discretionary modernization investment at the expense of investments otherwise undertaken to

maintain high quality service for the general body of ratepayers, however. The Company's investments in the state must insure high quality service, as determined by this Commission. Appropriate regulatory measures will be taken to insure that this occurs.

The Commission finds that existing services are no longer adequate and concludes that the modernization plan is justified in that it brings telecommunications in Utah in line with present day service expectations. Therefore, it is appropriate to order the Company to provide central office upgrades estimated to cost \$36.35 million and fiber-optic extensions so that the fiber optic infrastructure extends from Logan to St. George, with digital microwave extensions to Vernal and Price, at an estimated cost of \$21.5 million. These figures are represented by the Company to be the costs associated with these modernization investments. The Commission is ordering the modernization of the network, not the Company's estimated costs. The investments will be subject to the normal prudence reviews in future rate cases. As previously noted, the Commission, in the past, has not found the Company's investments to be unreasonable or excluded them from rate base.

The Division and the Company supported the proposed extension of fiber to colleges, universities and high schools only where deemed to be economically justified. As noted above, originally the Company proposed that the estimated \$33.88 million to extend fiber to such institutions would be a part of the overall modernization plan. The Commission is satisfied by the testimony on the record, including that of the public witnesses, as to the benefits of such extension. The Commission finds that fiber to the colleges, universities and highschools in the Company's territory is in the public interest and

ought not be purely discretionary. The Commission further finds that the Company must work with the Division and the various interested educational interests in the state to devise a program entailing the investment for extending fiber to these institutions as part of the total modernization plan. Such plan shall include details of the rates to be charged education for use of the network. Institutions should be required to sign contracts, or otherwise demonstrate that they will utilize the fiber optic service and pay the rates determined, before construction is authorized. Such plan shall be submitted to the Commission within three months of this Order. The Commission further finds that all modernization investments must be completed within 54 months of the Order, and booked as completed.

#### V. INCENTIVE REGULATION PROPOSALS

In this proceeding, both USWC and the Division made proposals for the adoption of so-called "Incentive Regulation" plans in this jurisdiction. In essence, incentive regulation is based upon the assumption that traditional regulation does not provide sufficient incentives for regulated utilities to operate as efficiently as possible. Incentive regulation allows the utility to earn in excess of the authorized rate of return on equity with the hope that such overearnings will provide a greater incentive to management and employees to undertake additional efficiencies.

#### A. DISCUSSION OF PLANS

##### 1. USWC PLAN:

The term of USWC's plan is four years, commencing January 1, 1991 and terminating December 31, 1994. During the term of the plan,

## Addendum 4

PSC Order on Review dated August 13, 1991, in Docket  
Nos. 90-049-03 And 90-049-06

# DOCKETED

- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

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In the Matter of the Application	)	
of US WEST Communications for	)	<u>DOCKET NO. 90-049-03</u>
Approval of an Incentive	)	
Regulation Plan.	)	
	)	
In the Matter of the Investigation	)	<u>DOCKET NO. 90-049-06</u>
into the Reasonableness of the	)	
Rates and Charges of US WEST	)	<u>ORDER ON REVIEW</u>
Communications	)	

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ISSUED: August 13, 1991

BY THE COMMISSION:

By its Petition filed July 19, 1991, US WEST Communications (the "Company") requested that the Commission review and reconsider its Report and Order of June 19, 1991 in these two Dockets. In particular the Company argued that the Commission should reconsider certain aspects of its Order as follows:

1. The Commission should reconsider its interpretation of the parties' Stipulation on revenue requirement issues in that it is contrary to the intent of the parties.
2. The Commission should reconsider its order on network modernization in that it exceeds the Commission's authority, is not supported by the record, is a result that no party sought and deprives the Company of due process.
3. The Commission should reconsider the proposed incentive plan.
4. The Commission should reconsider the standards it adopted for interim decreases.

005695



5. The Commission should grant a stay of \$5.916 million of the rate decrease ordered.

6. The interim spread of the rate reductions to WATS and 800 services should become permanent.

The Committee of Consumer Services (the "Committee") also filed a request for review and reconsideration of certain aspects of the Commission's Order:

1. The Commission should reconsider the rate of return awarded if the Company opts out of the proposed incentive plan.

2. The Commission should reconsider its offer of an incentive plan because it has not made a finding that the rates under such a plan would be just and reasonable.

3. The Commission should reconsider its refusal to require the Company to provide data regarding the costs of developing, advocating and litigating the Company's proposed incentive plan.

4. The Commission should reconsider its adoption of an incentive plan in view of the constitutional challenge to the incentive plan statute.

5. All of the discussion in the Report and Order should be considered findings.

Finally, Intervenor-Petitioners filed a petition for reconsideration of certain aspects of the Commission's Order:

1. The Commission should reconsider the constitutionality of § 54-4-4.1.

2. The Commission should reconsider the increase in the Company's rate of return.

3. The Commission should reconsider its adoption of an incentive plan.

4. The Commission should reconsider the effective date of the incentive plan.

The Commission held a hearing to take oral argument on the petitions for reconsideration and based upon the filings and the argument presented makes the following ruling.

First with regard to the issues raised by the Company.

1. The Commission should reconsider its interpretation of the parties' Stipulation on revenue requirement issues in that it is contrary to the intent of the parties. The Company takes the position that the Stipulation as implemented in the Commission's Order does not represent the Company's understanding of its intent and meaning. According to the Company, standard rate-case annualizing and normalizing adjustments to actual 1990 performance data were contemplated by the Stipulation. At hearing, and again in review, it became obvious that the Division, the Company, and the Committee had different interpretations of the provisions of the Stipulation. The Committee's view of the Stipulation is the one the Commission finds most reasonable and which most closely resembles the plain meaning of the Stipulation as a whole. By forbidding updated information to be inserted into certain of the defined categories of Exhibit JE-1, submitted as an addendum to the Stipulation, and by limiting it to the others, paragraphs six and

seven, the Stipulation provides definition, certainty and finality, which permits the parties to devote limited resources to more pressing issues. To allow for the addition of new categories, as the Company suggests, makes the Stipulation vulnerable to endless debate and discovery, the very problems that stipulations are intended to avoid.

The Company calls unfair the correction made by the Commission to the annualization of the interim rate decrease category of Exhibit JE-1, asserting that the Commission has done what it has prohibited the Company from doing. However, as we tried to make clear in the Order, the interim rate decrease as shown on Exhibit JE-1 was incorrectly stated and we merely rectified it--we did not update it.

2. The Commission should reconsider its order on network modernization because it exceeds the Commission's authority, is not supported by the record, is a result that no party sought and deprives the Company of due process. As noted in our June 19, 1991 Order, the Company has been successful in selling us on the benefits and need for modernization of the network. Now that the Commission has determined that modernization is in the public interest and ordered that it be accomplished, but without the incentive plan the Company said it wanted, the Company argues that the Commission was obligated to tell it that the adequacy of network facilities would be an issue so that it could respond, otherwise the Company says it is deprived of due process. It strikes us that this is an amazing twist of the record.

By

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proposing the modernization, the Company put the adequacy of the system, central offices, backbone transmission, and rural distribution facilities, squarely in issue. The Company could not expect realistically that the Commission would approve an investment the size of the Company's proposed modernization and saddle ratepayers with the costs, if the present system were adequate. The Company has well demonstrated through its own witnesses and the public witnesses it orchestrated, that the network is not adequate to meet present and future public requirements and needs to be upgraded. We believe the Company has itself met the burden of showing inadequacy of the system, whether it intended to do so or not. In addition, based upon testimony of Division, Committee, and public witnesses, we find that the record contains specific instances where the current system is inadequate.

Furthermore, there is virtually no risk to the Company. The Company has convinced us that modernization is a prudent and necessary course and it will be allowed to earn a just and reasonable rate of return on the investment. Normally, if a regulated utility undertakes an investment in infrastructure, it is subject to the risk of a prudence review before the investment is allowed in rate base. However, where the investment is mandated by the regulator, the risk is narrowed to the question of whether the investment has been implemented in a prudent manner. We have no reason to think that the Company would not be prudent in implementing this investment. All of its prior investments have been allowed by this Commission.

As we said in our Order, the Commission decides what is and is not an adequate network. Section 54-4-7 is clear on its face. We have held a hearing at which the need for modernization was an issue. On the basis of the record we have found and concluded that the present network is inadequate and an upgrade of facilities is needed; the benefits of modernization exceed the costs. The Company was not constrained to make the case for modernization; their presentation was wholly voluntary. The Company could have cross-examined public witnesses or further clarified the testimony of Company witnesses. For its own reasons it elected not to do so. If it is true, as the Company suggests, that because the Company has not proposed a modernization program without an incentive plan, we are now forced to ignore the considerable testimony in support of modernization, it would seem that the tail wags the dog.

We would note that if the modernization program is not accomplished, present rates will be excessive because we have allowed depreciation rates to reflect the remaining lives of old equipment commensurate with the upgrades and replacements in the modernization program.

We also note that both the Division and the Committee recommended in this case that rural central office upgrades be ordered without an incentive plan, so the Company cannot be heard to say that that upgrade was not in issue, even by its standard. Indeed, McCaw proposed that all upgrades be made, even without an incentive plan. The Division and the Committee each took the

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position that the distance learning investments should not be made until there was sufficient demand and economic justification and that was embodied in our Order; the Company has simply been ordered to create and supply us with a plan setting forth details, including rates, and demonstrating utilization for distance learning upgrades.

3. The Commission should reconsider the proposed incentive plan. The Company has requested that we reconsider the incentive plan set forth in our Order and adopt the features of the plan which the Company proposed. The Company views our proposed plan as riskier for it than traditional rate regulation and lacking any meaningful incentives. In our minds, however, the plan formulated by the Company would have shifted excessive risk to the ratepayer. We have attempted with our plan to balance the risk and still provide incentives. The Company is on record in this case as viewing incentive regulation as a means to a higher rate of return. Under the terms of the Commission's plan, the Company would be able to earn 14 percent, a rate it said would be reasonable during the rate case.

The Company has argued that under the terms of our proposed plan it would not be allowed to file a rate case during the course of the plan. We had not intended that result and so state. We will strike the last sentence on page 100 of our June 19, 1991 Order. The Company would be free to file a rate case at any point that it felt rates were inadequate.

We are satisfied that the plan we proposed is in the public interest and have not been convinced otherwise. The Company argues there is no support in the record for the plan we advanced; we disagree. Even if there were not, so far as the Company is concerned, we are not bound by what witnesses may propose in the way of an incentive plan. We are not obligated to provide or approve any incentive plan. If, in our discretion, we conclude that a particular plan will advance the public interest, we may approve or proffer a plan. The Company has an absolute protection by way of the veto provided to it by the Legislature.

4. The Commission should reconsider standards for interim rate decreases. The Company argues that the standards for interim decreases differ unfairly from those associated with interim increases. We have already discussed and ruled on the issue of interim decrease standards in our June 22, 1990 Order and see no reason to depart from our conclusions there. The ratepayers and the Company are situated differently in significant ways (something even Company Witness Kyritz admitted in this case) and, therefore, different standards are warranted.

5. The Commission should order a stay of \$5.916 Million of the rate decrease ordered. The Company previously requested a stay of the entire amount of the rate reduction and we determined not to grant a stay for reasons set forth at that time. While the Company has delineated more precisely the amount it is contesting, the Commission is still not inclined to grant a stay since we are persuaded that a surcharge can be ordered. The Company may or may

not elect to appeal from our decision. If they do not, any stay granted by this Commission would be moot. If they do, the Supreme Court will doubtless be asked to rule on the issue.

6. The interim spread of the rate reductions to WATS and 800 Services should become permanent. The Commission will adopt the interim rate structure proposed by the Company as the permanent rate structure for WATS and 800 services, it appearing reasonable and no party objecting. However, the Company is directed hereby to provide the Commission within 90 days with the cost data for modifying the billing procedures for these services as proposed by the Division.

The Commission rules on the Committee's petition for reconsideration as follows:

1. The Commission should reconsider the rate of return awarded if the Company opts out of the proposed incentive plan. The Committee argues that if the Company opts out of the incentive plan proposed by the Commission, the Commission should lower the rate of return from 12.2 percent to 11.8 percent. The Commission's discussion and findings set forth in its June 19, 1991 Order adequately address the reasons for setting the rate of return at 12.2 percent. These reasons have nothing to do with the adoption of an incentive plan.

2. The Commission should reconsider its offer of an incentive plan because it has not made a finding that the rates under such a plan would be just and reasonable. The Committee takes the position that the record does not support a finding that



the Commission's proposed incentive plan will produce just and reasonable rates. We disagree. The incentive plan will be experimental, but common sense suggests that its characteristics will eliminate most if not all of the risks of incentive regulation to ratepayers and will in all likelihood result in benefits which could not be achieved under traditional regulation (e.g. the retroactive capture of overearnings). We consider that the June 19, 1991 Order adequately addresses the issue of an incentive plan and supplies adequate findings.

3. The Commission should reconsider its refusal to require the Company to provide data regarding the costs of developing, advocating and litigating the Company's proposed incentive plan. The Committee has not raised any argument different from those it previously raised in support of its petition and, therefore, the Commission is not persuaded that it should rule differently than it did before.

4. The Commission should reconsider its adoption of an incentive plan in view of the constitutional challenge to the incentive plan statute. As we stated in response to Intervenor-Petitioners' request for a declaratory order, the Commission must presume the constitutionality of legislative enactments. It is for the Courts to determine the constitutionality of the incentive legislation. We have fashioned an incentive plan based on our assumption that the legislation is valid constitutionally. If the Court ultimately rules to the contrary, we will govern ourselves accordingly.

5. All of the discussion in the Report and Order should be considered findings. The Commission is not a court of law. We do not evaluate issues in the way a court would. We do not take and consider evidence in the same way. It is true that we have quasi-judicial functions at times but as an administrative arm of the Legislature, we also have quasi-legislative and ongoing administrative responsibilities. We do not have the luxury of deciding a case and having done with it. That means that public policy concerns, informed judgment and forecasting always play a part in our determinations. We intend by this to draw attention to the fact that our orders are not going to be precisely like a Court's orders. The discussion portion of our orders is important as it relates to the conclusions we reach, i.e., contains support for our findings and conclusions. So-called "findings" are bolded for convenience of parties, not because they constitute the only relevant parts of an order. If the Legislature intends that we operate as a court and that our orders be constructed like a court's in all respects, then it must alter the way utilities are regulated.

We address the Intervenor-Petitioners' reconsideration requests as follows:

1. The Commission should reconsider the constitutionality of § 54-4-4.1. Intervenor-Petitioners reargue the constitutionality of the incentive regulation statute. We have clearly stated by earlier order our position that the Commission has no authority to consider and pass on the constitutionality of

legislative enactments. We have been presented no argument on review that persuades us that we should change our position.

2. The Commission should reconsider the increase in the Company's rate of return. Intervenor-Petitioners argue, as have the Committee, that the rate of return should be lowered to 11.8 percent. We have already dealt with this issue in connection with the Committee's petition for review and refer to that discussion.

3. The Commission should reconsider its adoption of an incentive plan. Intervenor-Petitioners argue that there are substantial administrative law and constitutional problems with the plan adopted by the Commission under § 54-4-4.1 in addition to the facial unconstitutionality of that statute. We rely on our discussion hereinabove and in the June 19, 1991 Order as justification for the proposed incentive plan.

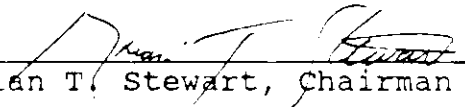
4. The Commission should reconsider the effective date of the incentive plan. Intervenor-Petitioners assert that there is serious ambiguity with establishing the date upon which the Commission's Order becomes final for purposes of reconsideration and judicial review. We have already dealt with this issue in considering Intervenor-Petitioners' petition for clarification and refer to that discussion. Intervenor-Petitioners also suggest that it is not clear whether the Company can reject only the incentive plan proffered by the Commission or the entire order. We do not share the view that the statute is ambiguous in that regard. It seems very clear on its face that the statute allows the Company to

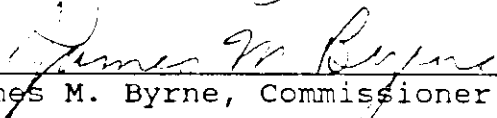
reject only those provisions of a Commission order which would require the Company to share revenues with ratepayers.


ORDER

NOW, THEREFORE, the Commission having considered the issues raised for reconsideration by parties in this proceeding, reaffirms its Order save for the clarification of the WATS and 800 service spread, the requirement of cost data in connection with WATS and 800 service and the clarification of the incentive plan proposed by the Commission as set forth hereinabove. The parties now have 30 days within which to petition the Supreme Court for review of the Commission's June 19, 1991 Order. However, the incentive plan portion of the Order will not become final for purposes of review until August 19, 1991, or until the Company accepts the incentive plan, whichever first occurs.

DATED in Salt Lake City, Utah this 13th day of August, 1991.

  
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Brian T. Stewart, Chairman

  
\_\_\_\_\_  
James M. Byrne, Commissioner

  
\_\_\_\_\_  
Stephen F. Mecham, Commissioner

ATTEST:

  
\_\_\_\_\_  
Stephen C. Hewlett  
Commission Secretary

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## Addendum 5

Application of US West Communications dated March 2,  
1990, in Docket No. 90-049-03

# ORIGINAL

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## BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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IN THE MATTER OF THE APPLICATION	)	Docket No. 90-049-03
OF U S WEST COMMUNICATIONS FOR	)	
APPROVAL OF AN INCENTIVE	)	APPLICATION OF U S WEST
REGULATION PLAN	)	COMMUNICATIONS

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Pursuant to Utah Code Ann. § 63-46b-3 et seq. and the Rules of Practice and Procedure Governing Formal Proceedings Before the Public Service Commission of Utah, The Mountain States Telephone & Telegraph Company, currently doing business as U S WEST Communications (hereinafter "USWC"), hereby requests that the Public Service Commission of Utah (hereinafter "Commission") approve the incentive regulation plan set forth in this Application.

## JURISDICTION

1. The Commission has jurisdiction over the matters requested in this Application pursuant to Utah Code Ann. §§ 54-4-1, 54-4-4.1, and 54-4-24.

## UTAH'S NEED FOR MODERN TECHNOLOGY INFRASTRUCTURE

2. The issues of economic growth and technology have been at the forefront of numerous activities in the past few years in Utah. Efforts such as the Governor's Blueprint for Utah's Economic Future, The Utahnet Task Force, the Utah Partnership for Educational and Economic Development, and the Information Technologies Task Force have focused, to various degrees, on the interrelationships between the development of a modern technology infrastructure in Utah and economic development and growth in the state. Each of these independent efforts has concluded that economic growth in Utah is dependent upon the development of a technologically up-to-date infrastructure. For example, among the many conclusions set forth in the Governor's Blueprint was the following:

Utah must assure quality infrastructure for the future. We must continue to maintain and develop our basic infrastructure. Utah must also focus on meeting the infrastructure demands of emerging industries. Attention must be paid to the growing needs for ground transportation throughout the state, well-planned airport developments, long-term water supplies, state-of-the-art utility networks, quality public and higher education systems, sound health care systems, tourism support services, and effective utilization of public lands. [Emphasis added]

Governor's Blueprint for Utah's Economic Future, Policy Statement, at 11 (November 1989).

## CENTRAL OFFICE REPLACEMENTS

3. In the USWC service territory in Utah, 48 central offices are still served by electromechanical technology (Cross-bar and Step-by-Step). Most of these central offices are located in rural parts of the state.

4. Under planning guidelines that are the product of a traditional regulatory approach, these central offices would be replaced only when growth or other factors relating to cost provide a trigger indicating that change-out of the central office is justified based on exhaustion of facilities. Given the minimal growth in virtually all of these communities, few of these central offices would be replaced in the foreseeable future.

5. There are numerous advantages that would result from a program to replace all electromechanical central offices with electronic digital central office switches:

- The 48 central offices (most of which are in rural areas) can be upgraded to digital technology without a current need to increase telephone rates.
- It would provide all of USWC's Utah customers with access to electronic technology and eliminate the substantial technology differences between urban and rural customers.



- Greater options will be open to USWC customers, among them equal access to interexchange carriers for interLATA calling and access to custom calling features, such as call waiting, call forwarding, three-way calling, and speed calling.
- Electronic technology would provide USWC customers with faster call completion, clearer voice transmission, increased data transmission accuracy, and faster Touch-Tone signal processing.
- Central office upgrades would enhance the availability and introduction of new services.

#### ENHANCEMENT OF FIBER OPTIC AND DIGITAL MICROWAVE NETWORK

6. In the past several years, USWC has deployed a "backbone" fiber optic and digital microwave network throughout portions of its service territory in Utah. This network, in conjunction with the deployment of advanced switching technologies, has enhanced the efficient and cost-effective delivery of quality telecommunications services by USWC. The expansion and reinforcement of this network would be beneficial to the public for several reasons:

- An enhanced fiber optic and digital microwave network would provide the capability of implementing a Distance Learning Network to universities, colleges and high schools in the USWC service territory in Utah without the current need to

increase rates for telephone services.

- An enhanced digital network would provide Utah with the latest transmission technology available, which is essential for affordable high-speed data, interactive video and other services needed by business, education and government.
- Specific examples of the benefits of enhancing the digital network are:

- Education. The lack of parity between rural and urban schools has long been a concern of educational leaders. Often in smaller school districts there are not enough students with specialized needs or interests to economically justify teachers or programs to meet those needs or interests. An education network would allow the augmentation of existing school curricula by providing students in remote locations with access to specialized training in a cost effective manner. It would also allow teachers more effective remote access to training classes so that their skills can remain current.
- Libraries. Improving the availability of information through common data bases can optimize the use of the limited resources of the libraries in the state. An enhanced digital network will make information, particularly specialty data, more accessible on a cost-effective basis.

- Rural Hospitals. Small community-based hospitals struggle to provide medical services with limited means. Through high speed data and interactive video capabilities, an expanded digital network could allow small hospitals and clinics access to the resources, including medical information, now available only in urban medical facilities. The benefits to rural health services are obvious.
- Research and Higher Education Applications. Enhanced capability of communicating, whether through high speed data or video, between universities and colleges in Utah would provide obvious benefits to the state. For example, the ability for private high technology businesses to access the University of Utah's super-computer or data bases located at Utah State University would provide positive economic development opportunities.

- By upgrading the digital infrastructure, all customers, whether business or residential, will benefit through the expanded services and efficiencies offered through digital technologies.

7. In determining the size of an enhanced fiber optic and digital microwave network, the following requirements would need to be considered:

- A distance learning video network, providing two-way interactive video capabilities between universities, colleges, and high schools.
- High capacity connections between the University of Utah super-computer and other universities and colleges.
- The implementation of a higher education library network.
- The State of Utah digital network.
- Utah State University's COMNET system.
- A backbone network for Utah Public Safety requirements.

#### ECONOMIC DEVELOPMENT AND GROWTH

8. Replacement of electromechanical central offices and enhancement of the fiber optic and digital microwave network represents a major commitment to the telecommunications infrastructure in the State and would substantially enhance the ability of the State to promote economic growth in the following ways:

- Business Attraction. Businesses looking to locate in Utah invariably inquire about telecommunications services. They want both digital switching and access to fiber optic technology.

- Business Retention. A quality business climate, including access to modern technology (and the competitive edge it supplies), is essential to retaining existing Utah businesses.
- Business Expansion. As small and medium sized businesses grow they must maximize their use of limited resources. For example, one of the most common means of business expansion is to open branch offices, a move that requires reliable communications for both voice and data. Modern technology provides the means to expand.

**SHORTENED AMORTIZATION OF ELECTROMECHANICAL  
CENTRAL OFFICE EQUIPMENT**

9. In the event a plan is adopted to replace all electromechanical central offices in the near future as part of an incentive regulation plan, it would be reasonable to remove the existing undepreciated investment in electromechanical central office facilities from the books in an accelerated fashion, similar to the shortened amortizations of inside wire and riser cable that were previously approved by the Commission. With the adoption of an incentive regulation plan and the implementation by USWC of an accelerated central office replacement program, the remaining investment in electromechanical central office equipment can be amortized over a three year period without the current need to increase rates in Utah. Such action would result in the recovering of that investment in a reasonable period without

burdening future ratepayers with it when it is no longer in use.

## INCENTIVE REGULATION

10. In the 1990 general legislative session, the Utah Legislature passed Senate Bill 115. Senate Bill 115 was signed by Governor Bangerter on February 28, 1990 and becomes effective on April 23, 1990. Among other things, Senate Bill 115 enacted a new section, Utah Code Ann. § 54-4-4.1(1), into the general utility laws:

(1) The Commission may, by rule or order, adopt any method of rate regulation consistent with this title, including a method whereby revenues or earnings of a public utility above a specified level are equitably shared between the public utility and its customers.

11. Incentive regulation offers the Commission and USWC a valuable, forward-looking tool for improving productivity beyond levels otherwise achievable. Benefits for customers include:

- The ability to receive the benefits from the greater efficiencies stimulated by incentive regulation, while maintaining rate stability.
- An improved environment for economic development from the incentives that will attract investment in Utah's telecommunications infrastructure.
- Reduced cost of regulation from the simpler approach offered

by incentive regulation for dealing with USWC's earnings. At the same time, incentive regulation is more responsive to the increasingly dynamic environment in the telecommunications industry.

- The ability, through an incentive plan, for ratepayers to reap, on a retroactive basis, a portion of the benefits of cost-cutting and greater efficiency that occur in a prior year.
- The added incentive to USWC to manage its investments more efficiently.

12. Incentive regulation plans for telephone utilities have been adopted in eighteen different jurisdictions in the United States and are under consideration in fourteen more.

13. Recent findings by the Washington and California Commissions highlight some of the benefits of incentive-based regulation:

- "It is the Commission's view that this plan is a modified form of rate base regulation coupled with incentive regulation, which we believe is better suited to achieving the policy goals of this state and the needs of its citizens than the traditional form of rate of return, rate base regulation. The Commission finds that the proposed plan, as modified by the Commission, ensures ratepayers will benefit from efficiency gains and cost savings arising out of regulatory change and will afford ratepayers the opportunity to benefit from improvements in productivity due to technological change. The modified plan will not result in a degradation of the quality or availability of efficient telecommunications services. It will produce fair, just, and reasonable rates and will not unduly or unreasonably

prejudice or disadvantage any particular customer class." Washington Commission Order, Docket Nos. U-89-2698-F and U-89-3245-P, January 16, 1990, at 25)

- "The modified plan for an alternative form of regulation will reduce regulatory delay and costs, . . . will encourage innovation in services, . . . will promote efficiency, . . . [and] facilitates the broad dissemination of technological improvements to all classes of ratepayers." (Washington Commission Order, Docket Nos. U-89-2698-F and U-89-3245-P, January 16, 1990, Findings 10-13)
- "The incentive-based regulatory framework is likely to perform better than traditional regulation in encouraging appropriate technological advance and full utilization of the local exchange network. . . ." (California Commission Order, Decision 898-10-031, October 12, 1989, Finding 106.)

14. The plan described hereafter is in the public interest of USWC ratepayers and of the citizens of the State of Utah.

#### PROPOSED PLAN

I. The following plan is proposed by USWC as an integrated and fully dependent proposal.

II. Contingent upon the adoption by the Commission of an incentive regulation plan as described below, USWC hereby proposes to deploy the following network modernization plan:

A. Network Modernization. USWC proposes, as part of the Plan, to (1) replace all 48 remaining electromechanical central offices in Utah with digital technology over a 3 to 5 year period and (2) extend and substantially reinforce USWC's



fiber optic and digital microwave network in Utah in the same period. The total impact of both portions of the plan is approximately \$100 million more investment over the term of the plan than under a business as usual plan.

The plan of USWC to replace all electromechanical central office involves the investment by USWC of approximately \$50 million more over the next 3 to 5 years than under a business as usual plan. In addition to replacement of electromechanical offices, the plan also upgrades, from analog to digital, the interoffice facilities between associated USWC offices. The 48 offices to be converted to digital technology are listed on Attachment A. This list may be augmented or advanced to an earlier conversion as warranted by engineering or service requirements. The plan is subject to factors beyond the control of USWC, such as equipment or labor availability. Detailed engineering of the modernization for offices not already scheduled for conversion in 1990 will begin following approval of the Plan by the Commission and USWC. USWC will report annually to the Commission on the progress made with its central office modernization plan.

The proposal to extend and reinforce the deployment of fiber optic and digital microwave technology involves the additional investment of approximately \$50 million of capital more than under a business as usual plan. As part of the plan, the Company would expend approximately \$10 million to

add new fiber optic routes and to reinforce the existing fiber optic and digital microwave network in Utah. Among the items in this plan are the extension of fiber optic technology to Richfield and Cedar City and the expansion of digital capacities to Logan, Price and Vernal. Another major part of the plan (about \$40 million of the approximate \$50 million) involves extending the fiber optic or digital infrastructure from the expanded backbone network to communities throughout USWC's service area in Utah. This includes placing fiber optic or digital microwave interoffice facilities from the backbone network to central offices. It would also include placing fiber optic or digital loop facilities from those central offices to universities, colleges and high schools in USWC's service territory. Extending the digital telecommunications infrastructure in this manner will, in addition to making a Distance Learning Network available, make the benefits of digital information transport widely accessible to small and large businesses, research activities, government, education, libraries, and public safety institutions. Among the items included in this plan are the placement of an interactive video network to high schools, colleges and universities in USWC's service territory in Utah. Attachment B sets forth the specific projects that would be completed under this plan.

For intrastate regulatory accounting purposes, USWC further proposes that the added investment resulting from the

entire network modernization plan be treated as though the investments had been placed in equal amounts in each year from 1990 through 1994.

B. Shortened Amortization of Existing Electromechanical Central Office Investment. For Utah intrastate regulatory accounting purposes, USWC requests the authority to book the depreciation of all remaining intrastate investment in electromechanical central office equipment on a three year amortization schedule, commencing within a reasonable time after the approval of the incentive regulation plan by the Commission so that the amortization would occur during the same general period that the additional investment for new central office equipment is being placed. The additional depreciation would amount to approximately \$3.8 million annually.

C. Incentive Regulation Plan. USWC's pursuit of the above-described modernization plan is dependent upon Commission approval, which is hereby requested, of an incentive regulation plan containing the following basic elements:

- (1) All annual Utah intrastate earnings (determined on a calendar year basis) that exceed a 14.0 percent regulatory return on equity shall be shared. Fifty (50) percent of earnings above the sharing level

would be returned to customers in the form of credits and 50 percent retained by USWC. Based on the Company's current analysis of all the factors appropriately used to determine a regulatory return on equity, together with the fact that there is substantial risk to the Company in entering a four-year incentive plan (with limited ability to initiate a rate case if capital costs change dramatically), a 14.0 percent return on equity for sharing purposes is fair and reasonable.

(2) The term of the plan shall be from January 1, 1990 to December 31, 1993 (four years). Applying the effective date retroactively recognizes that this proposal will require hearings that could extend well into 1990 and provides a mechanism to protect both customers and USWC from uncertainties in projections that are initially relied upon, but which could change before the end of the year.

(3) USWC shall not be able to commence a rate case during the term of the plan unless its annual Utah intrastate earnings are affected by significant events and go below a 10.5 percent regulatory return on equity for a full calendar year.

(4) The Company plans, through separate proceedings, to seek pricing flexibility for services that are competitive under the provisions of Utah Code Ann. § 54-8b-3. Under the incentive regulation plan

proposed in this Application, rate increases or decreases for essential services for which pricing flexibility has not been granted would not be made during the term of the plan, except to reflect the net impact of the following items, which would, under the plan, be pass-through items: (1) the impact of Commission-approved accounting changes required by the FASB, such as a Commission-approved implementation of accrual accounting for post-retirement medical and dental benefits (PRMD), (2) changes in federal taxes, and (3) FCC-mandated separations changes. Such changes would be made only once annually, if necessary.

A detailed incentive plan shall be filed by USWC on or before March 26, 1990. Testimony supporting the incentive and network modernization plans shall be filed on or before April 30, 1990.

NOW, THEREFORE, USWC hereby requests that the Commission:

1. Establish a formal docket to consider the plans and requests of USWC set forth in this Application and as further detailed in future filings of USWC.

2. Order USWC, the Division of Public Utilities, the

Committee of Consumer Services, and any other interested parties to convene a settlement conference pursuant to Utah Code Ann. § 54-7-1 to engage in preliminary discussions of the proposals of USWC. Section 54-7-1(1) encourages the informal resolution of matters before the Commission. USWC is aware of the Commission's position that it will not approve an incentive regulation plan without being fully convinced that it is in the public interest. Nevertheless, USWC believes it would be beneficial for the parties to address issues relating to modernization and incentive regulation in an informal manner before hearings. This will provide the parties the opportunity to focus issues before hearings commence and will possibly facilitate agreement on some issues.

3. Establish a date for a Pre-Hearing Conference for the purpose of setting the date for a Settlement Conference and to address other procedural issues, such as a schedule for discovery, testimony filing dates and hearing dates.

4. Following notice and hearings, find that the plan proposed by USWC is in the public interest.

5. Approve the incentive regulation plan proposed by USWC in this Application or such plan as may be modified by agreement of the parties.

DATED this 2nd day of March, 1990.

U S WEST Communications:

By W. Mack Lawrence  
W. Mack Lawrence  
Utah Vice President & Chief  
Executive Officer

By Ted D. Smith  
Ted D. Smith  
Chief Counsel-Utah

Central Office Modernization Proposal

The following is a list of offices proposed to be modernized with digital technology:

Beaver	Morgan
Bicknell	Mountain Green
Bryce Canyon	Mt. Pleasant
Cedar City *	Panguitch
Circleville	Parowan
Coalville	Payson
Corinne	Price
Duchesne	Richfield
East Carbon	Richmond
Enterprise	Roosevelt
Ephraim	Salina
Eureka	Scofield
Garden City	Smithfield
Goshen	Spanish Fork
Green River	Springdale
Hanksville	Vernal
Hatch	Veyo
Heber City	Wendover
Helper	
Hiawatha	
Huntington	
Hyrum	
Leeds	
Lehi	
Loa	
Logan *	
Marysvale	
Milford	
Minersville	
Monroe	

\* Denotes a "lineless host" to support remote switches in other nearby exchanges. The existing switches at the locations of the lineless hosts are not planned for replacement, because they are already electronic.

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Fiber Optics/Digital Network Expansion Proposal

Extension of "Backbone" Fiber Optic Network Facilities

- Provo to Richfield
- Richfield to Cedar City

Expansion of Existing Backbone Fiber Optic Routes

- Salt Lake to Ogden
- Ogden to Brigham City
- Salt Lake to Provo

Expansion of Existing Digital Microwave Routes

- Brigham City to Logan
- Provo to Price
- Price to Vernal

Extended Network

- Interoffice facilities extending from the backbone digital network to central offices that serve high schools, colleges, and universities in USWC's service territory.
- Digital local loop facilities connecting high schools, colleges, and universities to serving central offices.

## Addendum 6

Rebuttal Testimony of Larry F. Fuller for the Division of  
Public Utilities

RECEIVED  
EXHIBIT NO. 7R  
Case 90-049-03  
Date 10-24-90  
Witness Full  
Recorder WENTZ

OCT 24 4 17 PM '90

- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

---

IN THE MATTER OF THE APPLICATION OF	)	DOCKET NO. 90-049-03
US WEST COMMUNICATIONS FOR APPROVAL	)	
OF AN INCENTIVE REGULATIONS PLAN	)	EXHIBIT NO. <u>DPU</u>

---

REBUTTAL TESTIMONY OF  
LARRY F. FULLER

FOR THE  
DIVISION OF PUBLIC UTILITIES  
DEPARTMENT OF COMMERCE  
STATE OF UTAH

OCTOBER 24, 1990

006024

1       TRADE OFF FOR SOME ACCELERATED REPLACEMENT OF THE X-BAR AND  
2       SXS OFFICES, DOES THAT MEAN THE COMPANY WILL HAVE RECEIVED  
3       THE EARNINGS BENEFITS FROM ITS PAST REDUCED CONSTRUCTION  
4       DECISIONS, AS WELL AS RECEIVING THE FUTURE EARNINGS  
5       BENEFITS?

6    A.       Yes. The company will not have to realize detrimental  
7       financial consequences from its past decisions to not  
8       invest in Utah.

9               III. TECHNOLOGICAL CHANGES ARE REQUIRED

10   Q.       WHAT ARE THE GENERAL CONSIDERATIONS WHICH INFLUENCED THE  
11       PAST NEED FOR TECHNOLOGICAL CHANGES TO THE LOCAL AND TOLL  
12       NETWORKS?

13   A.       During the monopoly years of telecommunications,  
14       technology changes were primarily being driven by the need  
15       to improve the quality, efficiency, compatibility and costs  
16       of the networks. Market demand generally resulted from the  
17       use of the services that became available. In World War  
18       II, there was a major reliance on telecommunications  
19       services, especially for the needs of the military, civil  
20       government and large business customers.

21       The research and development required to satisfy the  
22       resulting national and international market demands, along  
23       with the changes being made by the telephone industry to  
24       reduce costs and improve service, resulted in technological

1 changes which made network switching equipment and  
2 facilities outdated nearly every decade. Although the  
3 telecommunication demands of businesses and governments  
4 were more varied and complex, the residential demands for  
5 privacy, quality, service availability, lower prices,  
6 direct dialing, faster network response, custom calling  
7 features and touchtone dialing were met at the same time.  
8 Along the way, special products carried by telephone  
9 companies, such as, nationwide TV and Audio Broadcasting  
10 benefitted residence subscribers indirectly. Such special  
11 products helped pay for the inter change facilities  
12 required for telephone, data and facsimile services  
13 networks.

14 The result of the technological evolution can be seen  
15 in Utah. Step-by-step (SXS) switching is of the 1940's  
16 vintage, Cross-Bar (X-BAR) switching is of the late 1950's  
17 and early 1960's vintage, electronic analog switching (ESS)  
18 is of the late 1960's and early 1970's vintage, and  
19 electronic digital switching (DSS) is of the late 1970's  
20 and early 1980's vintage.

21 The technology changes for interexchange facilities  
22 changed from the pre-1900 vintage 1/8 inch diameter aerial  
23 wires, to low capacity cables and radio systems, to high  
24 capacity cable and radio systems, and now to ultra-high  
25 capacity fiber cable systems.

26 Changes to the local exchange facilities have not been

1 as dramatic, but we have seen the evolutionary introduction  
2 from the 1900 vintage aerial wire, to low capacity cable  
3 systems, to high capacity cable systems, to pair gain  
4 system applications, and now fiber cable systems.

5 All types of switching and almost all types of  
6 facility technology are in use in Utah today.

7 Q. DOES THE CONTINUED USE OF THE VARIOUS TECHNOLOGIES CREATE  
8 HIGHER COSTS AND EXPENSES?

9 A. Yes. Each type of switching office has its own  
10 operating characteristics. When they are interconnected  
11 with other types of offices, interface equipment is needed  
12 to correct or compensate for the differences. Some  
13 examples are:

14 1. The obsolete SXS offices do not switch or send  
15 signaling pulses at the speed the other offices are  
16 designed to accept. The interface equipment must tell  
17 the other offices to slow down until the SXS can  
18 finish sending or until it can finish sending to the  
19 SXS.

20 2. Interexchange or interoffice analog facilities  
21 must use carrier or multiplexing equipment to create  
22 individual 4000 cycle voice channels for operating  
23 between and through analog switching offices. The  
24 multiplexing equipment is expensive. Interexchange or  
25 interoffice digital equipment between digital offices  
26 interconnect with 1,500,000 bits per second, or

1 faster, digital groups and the signaling and  
2 intelligence is sorted out by time division  
3 sequencing. The digital methods are much less  
4 expensive than the analog multiplexing methods for the  
5 same capacities.

6 3. When an analog switching office has facilities to  
7 a digital switching office, equipment is required to  
8 convert from analog sound cycles to digital bit  
9 streams or visa versa. This conversion equipment is  
10 expensive.

11 4. Maintenance of the SXS is much higher than the  
12 ESS and the ESS is higher than the DSS.

13 5. Maintenance of analog facilities is higher than  
14 digital facilities.

15 6. Electric power consumption of SXS offices is  
16 higher than the ESS or DSS offices. This fact effects  
17 the expense and costs of both the normal operating and  
18 standby power systems.

19 7. Central office service order, testing and some  
20 maintenance work can be performed remotely for ESS and  
21 DSS. Technicians and installation personnel must be  
22 dispatched to perform all service order, testing and  
23 maintenance work for all SXS offices.

24 8. Equipment support by manufacturers is nearly non-  
25 existent for SXS offices. Repair parts and  
26 additional new equipment are now expensive per

1 customer service, as compared to equivalent ESS and  
2 DSS systems.

3 9. The SXS offices are not capable of allowing  
4 customers to participate in the types of information  
5 service markets that are explained in the testimony of  
6 USWC witness Mr. Davidson.

7 Q. WHAT HAS BEEN THE IMPACT TO CUSTOMERS THAT CONTINUE TO BE  
8 SERVICED BY THE SXS EQUIPMENT?

9 A. Some examples of the impact to the customers are:

10 1. Customers using touchtone telephones from a SXS  
11 office can dial much faster than the office can step  
12 through and connect to another customer in the same or  
13 different central office.

14 2. Business customers try to interface their modern  
15 digital station equipment to the SXS. The result is  
16 constant complaints and maintenance problems.

17 3. Business and residence customers that use  
18 computers for agricultural database systems, banking,  
19 broker inquiry, credit card verification and input,  
20 facsimile, etc. must use slow speed data interfaces if  
21 they are served by a SXS. Most database systems,  
22 banks, brokers, credit card companies and facsimile  
23 machines don't program to operate at the slower speeds  
24 without special rates and arrangements.

25 4. Trouble detection for customers served from SXS  
26 offices requires a person to be dispatched to the



1 central office. Trouble detection and tracing can be  
2 done remotely for ESS, DSS and some X-BAR offices.  
3 Dispatch and repair time is therefore much longer for  
4 SXS customers, especially for customers in the rural  
5 areas.

6 5. Rural customers served by most of the SXS offices  
7 cannot have interstate equal access or presubscription  
8 to long distance carriers or resellers. Since most  
9 rural customers make five to ten times more long  
10 distance calls than urban customers, this is  
11 potentially a major personal economic disadvantage to  
12 the rural customers.

13 6. Efforts by the Counties, Cities and U.S. West to  
14 provide Enhanced 911 emergency reporting service have  
15 been delayed due to the significantly higher costs  
16 created by the SXS interface equipment.

17 7. Customers served by SXS offices do not have the  
18 options for having basic or enhanced custom calling  
19 features and services, lower priced local exchange  
20 message rated services, remote call forwarding, custom  
21 intercept services, call restriction or blocking for  
22 976 or 900 numbers, CENTRON services, Direct-Inward-  
23 Dialing, all 800 subscription services, SDN, ISDN and  
24 other services readily available to over 90 percent of  
25 the other USWC customers.

26 8. The rural communities served by SXS offices are

1 greatly handicapped in their efforts for economic  
2 development and expansion. Modern telecommunications  
3 options would be a primary requirement for any company  
4 that would consider locating in a rural area.  
5 Existing businesses are unable to economically expand  
6 their business operations and presence without modern  
7 telecommunications options.

8 9. Rural customers are more reliant on their  
9 telephone service because of the alternate costs of  
10 traveling to their essential personal, commercial,  
11 social and governmental services locations.

12 IV. MODERNIZATION OF CENTRAL OFFICE SWITCHING EQUIPMENT

13 Q. DOES THE DIVISION SUPPORT THE MODERNIZATION AND REPLACEMENT  
14 OF THE OBSOLETE CENTRAL OFFICE SWITCHING EQUIPMENT IN THE  
15 RURAL AREAS?

16 A. The Division strongly supports the replacement of the  
17 obsolete equipment. In my testimony for the past USWC rate  
18 case Docket No. 88-049-07, I presented most of the  
19 preceding facts to justify accelerating the replacement of  
20 all of the X-BAR and SXS central office equipment. Three  
21 USWC witnesses opposed our proposals in that Docket on the  
22 basis that growth did not justify the required investments.  
23 USWC witnesses are now using justifications that are  
24 similar to the Division's for accelerating the

Addendum 7

Exhibit No. 5 of USWC Witness

W.H. Davidson

EXHIBIT NO. USC 6  
Case 70-140  
Date 2-1-61  
Witness Randall  
Reporter WENDY K. RANDALL

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

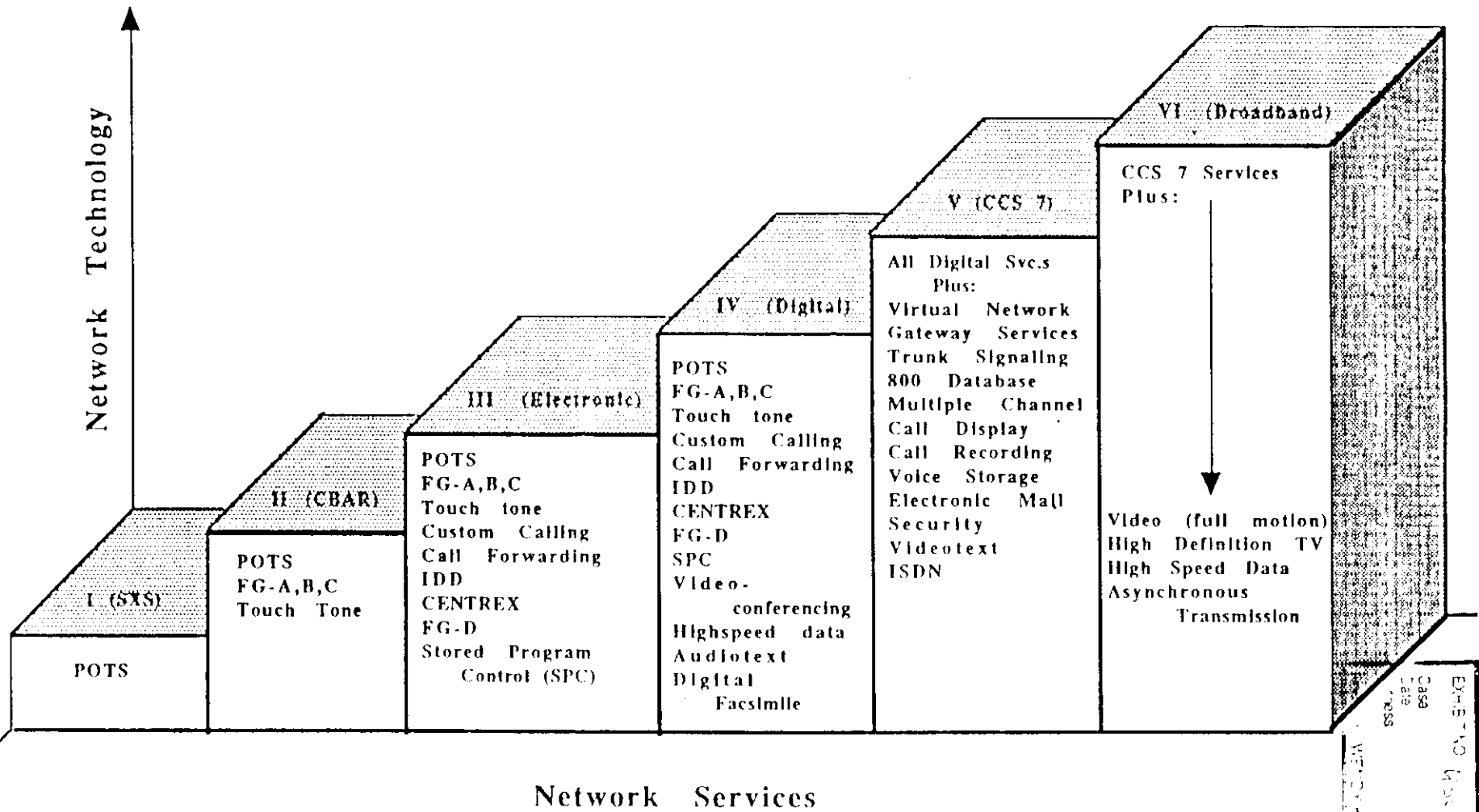
In the Matter of the Application  
of U S WEST Communications for  
Approval of an Incentive  
Regulation Plan

Docket No. 90-049-03

VERIFIED WRITTEN DIRECT  
TESTIMONY OF  
WILLIAM H. DAVIDSON

007982

# NETWORK EVOLUTION AND CUSTOMER SERVICES



008028

## Addendum 8

Direct Testimony of Robert C. Fuehr, USWC's Chief  
Executive Officer in Utah

EXHIBIT NO.	USWC 4
Case	90-049-06,03
Date	2-28-91
Witness	Fuehr
Reporter	WENDY K. RANDALL

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

---

IN THE MATTER OF THE APPLICATION )  
OF U S WEST COMMUNICATIONS )  
FOR APPROVAL OF AN INCENTIVE )  
REGULATION PLAN )

---

DOCKET NO. 90-049-03

IN THE MATTER OF THE )  
INVESTIGATION INTO THE )  
REASONABLENESS OF THE RATES )  
AND CHARGES OF U S WEST )  
COMMUNICATIONS )

---

DOCKET NO. 90-049-06

VERIFIED WRITTEN  
DIRECT TESTIMONY OF  
ROBERT C. FUEHR

FILE COPY

INDEX OF TESTIMONY

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1 Q. PLEASE STATE YOUR NAME, COMPANY AND POSITION.

2 A. My name is Robert C. Fuehr. I am employed by U S WEST  
3 Communications (USWC) as Vice President and Chief Executive  
4 Officer for the Company in Utah.

5

6 Q. PLEASE DESCRIBE YOUR BACKGROUND.

7 A. Please refer to my Exhibit 1 for a summary of my background.

8

9 Q. PLEASE DESCRIBE YOUR DUTIES AND RESPONSIBILITIES AS THE VICE  
10 PRESIDENT AND CHIEF EXECUTIVE OFFICER OF USWC IN UTAH.

11 A. As Vice President and Chief Executive Officer, I have  
12 responsibility for USWC's overall operation in Utah. That  
13 responsibility includes providing services that meet the diverse  
14 needs of our customers and managing our financial performance in  
15 Utah.

16

17 PURPOSE OF TESTIMONY

18

19 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

20 A. This testimony replaces the testimony originally filed by W. Mack  
21 Lawrence, who recently retired.

22

23 My testimony has three purposes. First, I will briefly outline  
24 the Company's proposal and describe my view of the role of  
25 telecommunications in the economic future of Utah. Next, I will  
26 discuss the relationship of cooperation and interdependence that  
27 exists between USWC and the people of the state of Utah.  
28 Finally, I will describe how our proposal for incentive

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1 regulation, central office modernization and infrastructure  
2 enhancement (the Plan) combines these elements into the basis for  
3 a mutually beneficial outcome for Utah as a whole. Specific  
4 details of the proposed Plan will be addressed by other witnesses.

5  
6 Q. PLEASE IDENTIFY THE OTHER WITNESSES WHO ARE TESTIFYING ON BEHALF  
7 OF U S WEST COMMUNICATIONS IN THIS PROCEEDING.

8 A. The other witnesses are Kirk R. Nelson, Assistant Vice President  
9 and Director of External Affairs in Utah, who describes the  
10 incentive portion of the Plan in detail and provides the  
11 rationale for moving to a modified form of regulation; Phillip S.  
12 Selander, Director-Network Facilities, who describes in detail  
13 the proposed central office modernization and network  
14 infrastructure enhancements; and Dr. William H. Davidson,  
15 Associate Professor of Management at the University of Southern  
16 California, who discusses some of the competitive, regulatory  
17 policy and economic grounds for approving the Plan. Rebuttal  
18 testimony has been filed by these same witnesses, as well as  
19 Karen M. Kyritz and Jerry D. Harris.

20  
21  
22 GENERAL DESCRIPTION OF THE PROPOSAL

23  
24 Q. PLEASE DESCRIBE IN GENERAL USWC's PROPOSAL AND ANY AMENDMENTS  
25 MADE TO THE PLAN SINCE ITS FILING.

26 A. Essentially, there are two, interdependent elements to our  
27 proposal. The first element of the Plan is an incentive  
28 regulation or "profit sharing" proposal whereby our Utah

1 customers and USWC will each receive a fifty percent share of  
2 profits above a predetermined earnings level.

3  
4 The second element is network modernization. Over a five-year  
5 period, we originally proposed to replace the 46 remaining  
6 electro-mechanical central offices in Utah and install two  
7 "lineless host" central offices using digital technology. Some  
8 of those central offices have now grown to their capacity and  
9 will be replaced in 1991 irrespective of the plan. Kirk Nelson  
10 and Phil Selander will deal more specifically with these  
11 amendments to the plan.

12  
13 We also propose to extend and substantially reinforce USWC's  
14 fiber optic and digital microwave network in Utah over the same  
15 period of time. Based on new forecasts and growth in the last  
16 year, some portions of this work will now be completed regardless  
17 of the status of the incentive plan. Once again, the specifics  
18 will be addressed by Mr. Nelson and Mr. Selander.

19  
20 Additional modifications impact the aspects of the plan which  
21 deal with distance learning. Due to technological breakthroughs  
22 and input from educators and others, we have amended the plan to  
23 provide fiber optic links to all colleges and universities under  
24 the plan. Given the new technological options, such as  
25 compressed video over copper facilities being developed at Utah  
26 State University, we believe that high schools should have the  
27 option to decide which services will best suit their needs.  
28 However, we are committed to keeping a pool of funds available to

1 fund the construction of facilities to high schools. Mr. Nelson  
2 will address these changes in more detail.

3  
4 USWC is committing up to \$91 million in incremental capital  
5 investment over and above the business as usual approach. The  
6 dollar amounts directed to each portion of the plan have been  
7 modified as a result of the plan amendments. The changes will be  
8 explained by Mr. Selander.

9  
10 Taken together, these elements form a package that is in the best  
11 interest of customers, the Company, and the future of  
12 telecommunications in Utah. The Plan also represents an effort  
13 by USWC to propose a plan consistent with those adopted by  
14 Commissions in other states. I believe this plan holds great  
15 potential for our state.

16  
17 Q. PLEASE EXPLAIN WHY YOU HAVE AMENDED THE ORIGINAL PLAN.

18 A. In the 12 to 18 months since the plan was originally designed, we  
19 have seen growth in some communities, completed new forecasts for  
20 some services and watched new technology evolve. In order to be  
21 responsive to evolving customer needs we have decided to move  
22 ahead with some projects that were originally part of our  
23 modernization proposal regardless of the status of the incentive  
24 plan. As a result, we have deleted from the plan the projects  
25 that we have now started or are firmly committed to in the  
26 future.

VIEW OF THE ROLE OF TELECOMMUNICATIONS

Q. PLEASE DESCRIBE YOUR VIEW OF THE ROLE OF TELECOMMUNICATIONS IN THE ECONOMIC FUTURE OF UTAH.

A. The telecommunications industry must continue to develop and strive to anticipate and meet the ever-expanding communications needs of a diverse group of Utah customers. Communications will become an even more critical link than it is today in the economic well-being and development of a highly mobile and technical society.

Business dealings increasingly will take our customers not only into national, but also international markets. The telecommunications industry and regulatory structure must be ready to meet the challenges that will accompany the role telecommunications will play in enhancing the global competitiveness of Utah businesses. That is especially important since Utah Governor Norman H. Bangerter has continued to emphasize economic development as one of his priorities and has dedicated state resources to that goal. We must position ourselves today to be a leader in Utah for the telecommunications needs of tomorrow.

Q. IN YOUR VIEW, WILL USWC AND OTHERS IN THE TELECOMMUNICATIONS INDUSTRY BE SERVING CUSTOMERS WITH WIDE VARIANCES IN COMMUNICATIONS NEEDS AND SOPHISTICATION?

1 A. Yes. There are a number of major consumer categories whose needs  
2 must be met in order to ensure both their success and our  
3 success. They include new and existing residential, small and  
4 large businesses and government/education customers. Obviously,  
5 many subgroups within these groups could be identified. Each  
6 will add to the challenge of requiring a technology  
7 infrastructure to meet its specific needs.

8  
9 While each of these markets have their own attributes and needs,  
10 all have at least one characteristic in common. They will demand  
11 more of telecommunications providers: more products, more  
12 advanced technology, more quality, more service and more  
13 choices. The Plan we have presented represents a major  
14 opportunity for Utah. Its implementation will allow Utah to  
15 remain competitive. It would be a headstart towards achieving a  
16 technological sophistication that is necessary for our customers  
17 and our state to maintain a competitive edge.

18  
19 Q. PLEASE DESCRIBE THE NEEDS OF THE RESIDENTIAL CONSUMER CATEGORY  
20 YOU ANTICIPATE SERVING.

21 A. While the traditional goal of "universal telephone service" --  
22 providing universally available basic service at reasonable rates  
23 -- will remain a priority, residential customers will  
24 increasingly recognize the value of new and innovative  
25 telecommunications services. The telephone will continue its  
26 evolution from a traditional communications device to a  
27 multi-faceted information management tool. In the fast-paced and  
28 sometimes hectic lives that our residential customers will lead,

1 numerous services will be offered to help them make the most of  
2 their time. Diverse telephone customers such as Minitel users in  
3 France and CommunityLink subscribers in Omaha, Nebraska already  
4 rely on their "telephone" for access to home shopping, banking,  
5 computers, libraries, and educational facilities. Other  
6 services, such as electronic yellow pages, ticket information and  
7 purchasing, sports and weather updates, and electronic messaging  
8 just to name a few, increase the value that residential customers  
9 place on their telephone service. Since not all customers will  
10 want or use the same services, it is key that we provide easy,  
11 affordable access to a wide variety of such services.

12  
13 Telephone companies must be equipped and positioned to satisfy  
14 these demands. This market will become increasingly competitive  
15 and sophisticated as technology continues to advance and as each  
16 telecommunications provider strives to find its market niche.

17  
18 Q. PLEASE DESCRIBE THE NEEDS OF BUSINESS CUSTOMERS IN YOUR VIEW OF  
19 THE FUTURE.

20 A. Growth will be critical to Utah's future and the ability to  
21 communicate will be essential to Utah's business customers. The  
22 availability of modern, efficient communications services will  
23 allow all businesses -- small and large -- to enhance their  
24 ability to be competitive in local, national, and international  
25 markets.

26  
27 Large business customers will demand a greater degree of control  
28 over their services. They want the ability to quickly and

1 reliably change various features and reconfigure their  
2 communications systems. New capabilities such as Integrated  
3 Services Digital Network (ISDN), which allows simultaneous voice  
4 and data transmission over the same line, will become more  
5 prevalent.

6  
7 Businesses which rely heavily on communications will demand  
8 features like USWC's recently introduced "Self Healing Network  
9 Services" which provide alternate routing of calls in the event  
10 of a service interruption. Self-healing network services are  
11 being introduced in Denver, Minneapolis, Seattle, Phoenix and  
12 Portland with implementation dates extending through July of  
13 1991. Other USWC cities, including Salt Lake City, will follow.

14  
15 Business customers, like residence customers, will become  
16 increasingly more sophisticated users of the technology made  
17 available to them and will demand continual advances in that  
18 technology. Economic competition in this country and abroad will  
19 demand it. Dr. Davidson addresses this issue in more detail in  
20 his testimony.

21  
22 Q. WHAT ROLE WILL TELECOMMUNICATIONS PLAY IN ATTRACTING NEW BUSINESS  
23 TO UTAH?

24 A. An advanced telecommunications infrastructure is an important  
25 factor in the business attraction formula. The availability of  
26 modern, efficient telecommunications is of great interest to site  
27 selection committees representing potential newcomers to Utah.  
28 As the ability and need to communicate take on greater importance

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1 within our society and economy, the "communications availability"  
2 factor will be weighted even more heavily in final location  
3 decisions.

4  
5 Some people liken the telecommunications infrastructure to an  
6 "electronic highway." Just as the interstate highway systems  
7 have greatly enhanced the economic well-being of states through  
8 the ability to efficiently move goods and people, a solid  
9 telecommunications infrastructure facilitates the moving of  
10 critical information quickly and efficiently. The inverse is  
11 also true; communities that failed to plan for growth when  
12 designing their transportation systems are now suffering traffic  
13 gridlock which makes the community less attractive as a place to  
14 locate a business.

15  
16 As such, the economic development of Utah hinges, in part, on the  
17 availability of modern, quality communications facilities. With  
18 all of the other qualities that Utah has to offer both potential  
19 employers and employees, it would be unfortunate to see Utah lose  
20 potential new businesses because of a lack of modern  
21 communications facilities. While USWC is committed to seeing  
22 that this doesn't happen, we cannot do it alone. We must all  
23 work together to make Utah's telecommunications system viable for  
24 present and future employers. Access to worldwide communications  
25 will be a major factor in the ability of new and existing  
26 businesses to maintain a profitable existence in Utah. As a  
27 result, the Utah link in the international network must keep pace  
28 with advances being made by not only other states but other  
29 nations.

1 Q. WHAT DO YOU FORESEE IN THE GOVERNMENT AND EDUCATIONAL MARKET?

2 A. Access to services and information by consumers, constituents and  
3 taxpayers on a timely and accurate basis will be an important  
4 measure of quality.

5

6 The sharing of information between government and educational  
7 institutions will continue to grow. Consequently, the role of  
8 the communications network will expand. Access to off-site  
9 databases and learning resources will be requirements of high  
10 quality education. In addition, outside the realm of  
11 "traditional" education, such services as home learning through  
12 personal computer applications and the concept of "distance  
13 learning" as an enhancement to classroom teaching will become  
14 increasingly widespread.

15

16 Utah already employs distance learning techniques to reach some  
17 outlying areas. The services provided to universities, colleges  
18 and vocational centers by the ED-NET system have proved the  
19 viability of using communication networks to supplement  
20 traditional teaching techniques.

21

22 Concepts like "video arraignment" -- whereby court proceedings  
23 can be conducted via an audio/video connection without incurring  
24 the cost, liabilities and danger of transporting a prisoner to  
25 the courtroom -- will see greater utilization. After a  
26 successful product trial in 1989, Multnomah County, Oregon,  
27 signed a contract for the Judicial Image Service. Fiber optic

1 lines are used to connect the courts in Portland with the  
2 penitentiary and correctional institute which are both located 45  
3 miles away in Salem. The result was a reduction in  
4 transportation, security and lodging costs. Even defense  
5 attorneys and inmates have expressed support for the system's  
6 convenience.

7  
8 The need for more cost-efficient governmental functions and  
9 services will increase the pressure on communications providers  
10 to be in a constant mode of upgrading features and facilities.

11  
12 Q. PLEASE SUMMARIZE YOUR FUTURE VIEW?

13 A. Utah will continue to be a prosperous and attractive place to  
14 live and work. Utah will be internationally competitive. A  
15 modern, progressive telecommunications industry will be important  
16 to Utah's success. Without a doubt, telecommunications will  
17 become an increasingly important factor in the continually  
18 changing social and economic fabric of our world.

19  
20 With all of Utah working together, this state has great potential  
21 to be an economic leader and commerce center as we move forward  
22 into the 21st century. As a matter of fact, the January 14, 1991  
23 edition of Fortune magazine calls the Provo-Orem area the  
24 nation's third largest cluster of high-tech enterprises, behind  
25 the Silicon Valley and the North Carolina Research Triangle.

26  
27 We have an opportunity to be among the front-runners in our  
28 telecommunications capabilities and applications, if we act now.

1 We can't afford to be left behind. My view of a highly mobile,  
2 highly technical, global society which relies heavily on the  
3 ability to efficiently communicate is not just a prediction for  
4 distant tomorrows -- it is becoming a reality today.

5  
6 MODERNIZATION ISSUES

7 Q. ABSENT APPROVAL OF YOUR PROPOSED PLAN, WHEN DO YOU EXPECT TO SEE  
8 THE REMAINING ELECTRO-MECHANICAL OFFICES REPLACED?

9 A. We have recently removed some projects from the modernization  
10 plan because they required immediate action, largely due to  
11 growth and new forecasts. However, without an acceptable  
12 incentive plan where the Company can reap some of the benefit of  
13 continual efforts to be more efficient and cost-effective, the  
14 Company will not make the discretionary incremental investment to  
15 modernize the remaining offices in the timeframe proposed in the  
16 Plan. Rather, we will continue to modernize these locations on  
17 an as required basis as growth or other factors in these  
18 communities trigger the physical or economic need to do so. In  
19 other words, we will upgrade those locations pursuant to the  
20 capital deployment procedures that were described to you in the  
21 last rate case by Mr. Motzkus and which were deemed to be a  
22 rational approach to capital deployment.

23  
24 Given the minimal growth that is taking place in many of these  
25 communities, it will be many years before most of these remaining  
26 locations become modernized under existing economic criteria.

1 Q. WHY, THEN, ARE YOU PROPOSING AN ACCELERATED MODERNIZATION AT THIS  
2 TIME?

3 A. We recognize the potential benefits of a program of this nature  
4 to the state and the Company. Additionally, at this time we have  
5 a window of opportunity to accomplish this project without rate  
6 increases for our customers. By combining the central office  
7 modernization and infrastructure enhancement in a package with  
8 profit sharing and incentive regulation, we are willing to make  
9 this major commitment to Utah. There will never be a better time  
10 to see this great opportunity occur.

11

12 Q. WHY DOES A PROFIT SHARING PLAN NEED TO BE INCLUDED AS PART OF THE  
13 PACKAGE?

14 A. As I mentioned, using traditional regulatory criteria, it will be  
15 a very long time before we can economically justify modernizing  
16 the network in many of these communities. In addition, while  
17 these switches aren't state-of-the-art, they are providing a  
18 level of service that allows us to meet and exceed standards for  
19 adequate service. So, from the standpoint of both pure economic  
20 and service standards, there is no requirement in today's  
21 environment for making this investment.

22

23 At the same time, it is clear to me that benefits from such an  
24 investment plan would accrue to Utah customers, particularly  
25 those in rural areas. To obtain the benefits of such an  
26 investment, a modified approach to the current method of  
27 regulation needs to be developed such that the total package of

1 incentive and investment makes sense -- both to the Company and  
2 its customers. The added profit incentives in the Plan are such  
3 that we are willing to bear the risks associated with the new  
4 investment and with a four-year rate freeze. This plan has  
5 lasting importance.

6  
7 Q. PLEASE DESCRIBE THE GENERAL BENEFITS OF YOUR PROPOSED  
8 ELECTRO-MECHANICAL CENTRAL OFFICE MODERNIZATIONS.

9 A. In addition to the broad economic development benefits which I  
10 described earlier, these upgrades will provide customers with  
11 such service improvements as more accurate processing of dialed  
12 digits, faster Touch-Tone signal handling, faster call completion  
13 and clearer telephone conversations and improved data  
14 transmission accuracy through quieter digital switching and  
15 transport.

16  
17 The digital switches and associated digital interoffice  
18 facilities also make new services and capabilities available to  
19 all of our customers. These include equal access to  
20 interexchange carriers for interstate calling and custom calling  
21 features such as call waiting, call forwarding, three-way calling  
22 and speed calling. Such improvements will bring our rural Utah  
23 customers the same features and functions that our urban  
24 customers enjoy.

25  
26 Q. PLEASE DESCRIBE THE GENERAL BENEFITS OF THE PROPOSED FIBER OPTIC  
27 AND DIGITAL INFRASTRUCTURE EXPANSION.

28 A. First and foremost, the enhancement of our fiber and digital

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1 microwave facilities will assist us in meeting the general  
2 demands for transporting messages. Such an expansion of Utah's  
3 telecommunications infrastructure will also be capable of  
4 supporting foreseeable, near-term needs such as state government  
5 digital telecommunications, super-computer access and  
6 communications, the public safety network, education networks and  
7 a statewide library network. In addition, the extended  
8 infrastructure will be capable of providing current and future  
9 benefits to research and development activities, businesses and  
10 residential customers.

11  
12 Q. ARE YOU PROPOSING TO BUILD THIS NETWORK ONLY FOR YOUR LARGE  
13 BUSINESS CUSTOMERS?

14 A. Definitely not. We must, of course, provide services that will  
15 be attractive to large business customers, who provide a  
16 significant percentage of our revenues. These changes will help  
17 meet their needs. On the other hand, the central office upgrades  
18 will clearly benefit residential and small business customers  
19 through new services. Similarly, all customers will be using the  
20 fiber facilities that we propose to place.

21  
22 Thus, continued modernization of the telecommunications network  
23 benefits a much broader customer spectrum than just big  
24 businesses. Many of these new products and services I have  
25 mentioned today, as well as many that haven't yet been developed,  
26 will ultimately find their way into the homes and businesses of  
27 many of our customers.

COOPERATIVE RELATIONSHIP

Q. PLEASE DISCUSS THE RELATIONSHIP THAT EXISTS BETWEEN USWC AND THE PEOPLE OF UTAH.

A. USWC is committed to contributing to the quality of life in our service territory. And, we are committed to providing customers with superior service. Our employees are an integral and active part of the communities in which they live. We have been and will continue to be an active and socially-conscious member of the business community.

Through our financial and volunteer efforts, USWC is a major player in economic development and other efforts which contribute to quality of life. We work hard to enhance and retain existing businesses, attract new industry and jobs and generally improve the way we live. Our intention is to continue to be an economic development force in the communities we serve. We want to meet the personal and professional communications needs of our residence and business customers through state-of-the-art telecommunications services. If they succeed, then we succeed as well. Consequently, we view our relationship with the state and its residents as one of cooperation and interdependence. It is the kind of relationship that extends far beyond simple telephone service transactions to a partnership to build a better future.



1 Q. WILL YOUR PROPOSED INVESTMENTS FURTHER YOUR COOPERATIVE  
2 RELATIONSHIP WITH THE STATE OF UTAH?

3 A. Absolutely. The Governor's Blueprint for Utah's Economic Future  
4 which was released in November 1989 and updated in the fall of  
5 1990, contains three messages. First, well-planned economic  
6 development will result in a better quality of life for our  
7 citizens. Second, we must encourage public and private sectors  
8 to share a common economic development mission. And, third, we  
9 must provide the necessary infrastructure in Utah for business  
10 growth and development. The telecommunications industry has a  
11 major role to play in carrying out these objectives. Clearly,  
12 the proposed central office modernization and digital network  
13 expansion are consistent with the Blueprint.

14

15 STATUS OF ALTERNATIVE FORMS OF REGULATION

16

17 Q. WHAT IS THE STATUS OF ALTERNATIVE FORMS OF REGULATION IN OTHER  
18 STATES?

19 A. By last count, 27 states have adopted some form of alternative  
20 regulation while at least 9 more are considering it. A quote  
21 from the California Commission is indicative of the underlying  
22 benefit of incentive regulation:

23 "It is the Commission's view that this plan is a modified  
24 form of rate base regulation coupled with incentive  
25 regulation, which we believe is better suited to achieving  
26 the policy goals of this state and the needs of its citizens  
27 than the traditional form of rate of return, rate base  
28 regulation."

1  
2 It is rapidly becoming a consensus that some modified form of  
3 regulation is needed to move this industry forward into the  
4 future. Our proposal is not plowing any new ground. We believe  
5 that the Plan fairly addresses this concern and places an  
6 appropriate amount of risk and opportunity on both the Company  
7 and its customers. The momentum in the country is clearly headed  
8 toward finding workable, alternative forms of regulation. Utah  
9 should join that trend by adopting our Plan.

10  
11 CONCLUDING REMARKS

12  
13 Q. DO YOU HAVE ANYTHING ELSE TO ADD TO YOUR TESTIMONY?

14 A. Yes. During my career, I have seen a great deal of change.  
15 These are exciting times in the evolution of this industry.  
16 This is a time of rapid change in technology, competition, the  
17 emphasis on economic development and the need for a more global  
18 and communications-oriented society. While the future is  
19 promising and dynamic, it is also less predictable than it was  
20 even a few years ago.

21  
22 I believe our industry will play an increasingly critical role in  
23 the shaping of our state and the nation -- both on a personal and  
24 business level. We need to move beyond the old assumptions  
25 underlying rate base, rate-of-return regulation that do not fit  
26 the new realities of this industry. We must cooperate to develop  
27 regulatory frameworks to facilitate these changes. We have an  
28 exciting opportunity now to move this industry forward.

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1           Thus, I urge and encourage the Commission to expeditiously adopt  
2           the plan as amended by the Company.

3       Q.   DOES THIS CONCLUDE YOUR TESTIMONY?

4       A.   Yes, it does.

## Addendum 9

Supplemental Surrebuttal Testimony of William W.  
Dunkel, for the Committee of Consumer Services

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

---

In the Matter of the	: SUPPLEMENTAL SURREBUTTAL TESTIMONY
Application of U S WEST	: of
COMMUNICATIONS for Approval	: WILLIAM W. DUNKEL
of an Incentive Regulation	: for the
Plan	: COMMITTEE OF CONSUMER SERVICES
	: Docket No. 90-049-03

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Supplemental Surrebuttal Testimony

February, 1991

1 Q. ARE YOU THE SAME WILLIAM DUNKEL WHO PREVIOUSLY PREFILED TESTIMONY  
2 IN THIS PROCEEDING ON BEHALF OF THE COMMITTEE?

3 A. Yes.

4

5 Q. WHAT IS THE PURPOSE OF THIS SUPPLEMENTAL SURREBUTTAL TESTIMONY?

6 A. The purpose of this supplemental surrebuttal testimony is to  
7 address the Company's new electromechanical switch replacement  
8 study.

9

10 Q. WHY DID YOU NOT RESPOND TO THIS NEW STUDY IN YOUR SURREBUTTAL  
11 TESTIMONY?

12 A. Because the Company provided the information on this new study  
13 after my surrebuttal testimony was already written and being  
14 shipped.

15

16 Q. WHAT DOES THIS NEW STUDY APPEAR TO SHOW?

17 A. Among other things, this new study claims to show that the  
18 electromechanical central office upgrades are, as a package, an  
19 uneconomical replacement.

20

21 Q. HAVE YOU HAD AN OPPORTUNITY TO REVIEW THE UNDERLYING ASSUMPTIONS,  
22 CALCULATIONS, AND DETAILS AND TO CONDUCT SEVERAL ROUNDS OF  
23 DISCOVERY AS NEEDED TO THOROUGHLY REVIEW THIS NEW COMPANY STUDY?

24 A. Of course not. This new study was made available only at the  
25 last minute after my last testimony in this proceeding was  
6 already written and in the process of being shipped.

2 Q. IN YOUR OPINION, WHAT WEIGHT SHOULD BE GIVEN TO A STUDY WHICH IS  
3 PROVIDED AT SUCH A LATE DATE THAT THE OTHER PARTIES HAVE NO  
4 REASONABLE OPPORTUNITY TO REVIEW, ANALYZE AND MAKE CORRECTIONS TO  
5 THAT STUDY?

6 A. Such a study should be given no weight. This study clearly  
7 produces an answer which fits the Company's arguments. The only  
8 way such a late study could be given any weight is if the  
9 Commission and other parties accept the study on faith.

10

11 Q. IS IT REASONABLE TO ACCEPT THIS NEW COMPANY STUDY ON FAITH?

12 A. No. The prior Company study of the economies of the central  
13 office replacement was not valid as originally provided by the  
14 Company. If an assumption as to the validity of the study must  
15 be made, the reasonable assumption based upon experience in this  
16 case would be that the Company study as originally provided is  
17 not valid.

18

19 Q. YOU REFERRED TO THE PRIOR COMPANY STUDY. HAD THE COMPANY  
20 PREVIOUSLY IN THIS PROCEEDING PROVIDED ANOTHER STUDY WHICH ALSO  
21 ORIGINALLY APPEARED TO SHOW THAT THE CENTRAL OFFICE UPGRADE AS A  
22 PACKAGE WAS NOT AN ECONOMIC UPGRADE?

23 A. Yes. The original economic analysis which the Company provided  
24 in this proceeding pertaining to the upgrades of the  
25 electromechanical offices appeared to show that these upgrades as  
26 a package were uneconomical. In the Company study as originally

1 provided, it also appeared that only seven of the offices could  
2 be economically replaced. This original study was provided in  
3 response to Request CCS02-002.15 on September 19, 1990. An  
4 update to CCS2.15 was provided on September 28, 1990.

5

6 Q. WAS THIS ORIGINAL COMPANY STUDY INACCURATE?

7 A. Yes. The inaccurate assumption in the original Company study was  
8 that no additional revenues were included in the study. In fact,  
9 there would be additional revenues with the upgrades because of  
10 revenues from additional services, such as custom calling, would  
11 be generated with the digital offices. These services and  
12 associated revenues are not available using the present  
13 electromechanical offices.

14

15 Because we have had time to review this original USWC provided  
16 study, and conduct discovery pertaining to this study, we were  
17 able to correct the inaccurate assumption which the Company used  
18 in the original study.

19

20 Q. WAS IT DIFFICULT TO OBTAIN THE DATA FROM USWC NEEDED TO CORRECT  
21 THE COMPANY'S ORIGINAL STUDY FOR THIS INACCURATE ASSUMPTION?

22 A. Yes. In our Request CCS10-010.1, we asked for the study results  
23 including the additional revenues.

24

25 The Company failed to provide this information in response to  
that request. This response was provided on November 1, 1990.



2 Q. DID YOU CONTINUE TO PURSUE THE CORRECTION TO THE ORIGINAL COMPANY  
3 STUDY?

4 A. Yes. In our Request CCS14-014.1 we again requested information  
5 pertaining to the additional revenues, and were successful in  
6 receiving that information in the Company's response to 14.1.  
7 This response was provided on December 11, 1990.

8  
9 Q. HOW LONG DID IT TAKE BETWEEN THE TIME THAT THE COMPANY'S ORIGINAL  
10 ECONOMIC STUDY PERTAINING TO THE ELECTROMECHANICAL UPGRADES WAS  
11 PROVIDED AND THE TIME THAT YOU FINALLY OBTAINED FROM THE COMPANY  
12 THE INFORMATION REQUIRED TO PROPERLY ANALYZE THE ECONOMICS OF  
13 THESE UPGRADES?

14 A. It took about three months from the time the Company provided the  
15 original study before we were able to illicit the corrected study  
16 from the Company.

17  
18 The original Company study made it appear that these office  
19 upgrades were not economical overall.

20  
21 The corrected study proved that these upgrades are economic  
22 overall.

23  
24 Q. WAS CORRECTING THIS STUDY A MAJOR EFFORT IN THIS PROCEEDING?

25 A. Yes. Although it has not been brought to the Commission's  
attention, one of the major efforts in the discovery phase of

1 this proceeding has been the effort to correct the improper  
2 assumption which was included in the Company's original economic  
3 analysis of these upgrades. It took about three months, and  
4 three rounds of discovery requests to correct the original study.  
5

6 Q. DID THE COMPANY WITNESSES AFTER THE RESPONSE TO 14.1 WAS  
7 RECEIVED, ADMIT THAT THESE UPGRADES WERE ECONOMIC?

8 A. Yes. The Company witness, Kirk Nelson, acknowledged that the  
9 overall central office upgrade package was an economic upgrade on  
10 page 41 of his rebuttal testimony. He was reduced to claiming  
11 that although it was economic, it was "suboptimal."  
12

13 Q. WHAT IS SCHEDULE CCS2SS.1?

14 A. Schedule CCS2SS.1 contains the sequence of our data requests and  
15 the Company's responses related to this subject. In the upper  
16 corner of each, we have typed the date on which each response was  
17 provided to us. Some of the Attachments to these responses are  
18 proprietary.  
19

20 Q. WHAT IS THE SIGNIFICANCE OF THE ABOVE INFORMATION?

21 A. There is nothing new about the fact that the Company can create a  
22 study which makes it appear that the upgrades of the  
23 electromechanical offices is uneconomic. The original study  
24 which they provided in this proceeding also made it appear that  
25 the upgrades of these offices was not economical overall.  
26

1 It took several months and three rounds of discovery requests  
2 before this original study was corrected. Only after the  
3 corrections was it clear that the COE upgrade package was  
4 economic.

5  
6 Q. WHAT BEARING DOES THIS HAVE ON THE STUDY WHICH THE COMPANY HAS  
7 FILED?

8 A. The Company has now completed a new study which again appears to  
9 show that the COE upgrade package is uneconomical.

10  
11 The Company has made this claim before, but we were able to prove  
12 that it was false. It took about three months and three  
13 discovery rounds to do so.

14  
15 Unfortunately, since the Company has filed this new study  
16 extremely late in this proceeding, we will not have time for  
17 three rounds of discovery nor will we have three months to  
18 address the new study.

19  
20 Q. WHAT DO YOU RECOMMEND PERTAINING TO THIS NEW CLAIMED ECONOMIC  
21 STUDY OF THE COMPANY?

22 A. I recommend that this study be considered an "unreviewed" study.  
23 As such, it should have no weight.

24  
25 Q. WHAT STUDY SHOULD HAVE WEIGHT?

26 A. The study which should have weight is the study which the other

1 parties have had the opportunity to review and to correct.

2

3 Q. WHAT REASON DOES THE COMPANY GIVE IN THEIR DATA RESPONSE FOR  
4 CREATING THIS LAST MINUTE NEW STUDY?

5 A. The Company stated that it performed this new study "due to the  
6 continued attention focused on these economic issues." (Page 2  
7 of the updated response to 2.15 dated February 13, 1991)

8

9 Q. DOES THIS REASON MAKE ANY SENSE?

10 A. Of course not. There has been a great deal of attention focused  
11 on the central office upgrade issue throughout this proceeding.  
12 The Company specifically made the replacement of the central  
13 offices one of the major issues upon which attention was focused.  
14 The explanation that attention was suddenly focused on the  
15 economics of these central office upgrades is not valid. The  
16 focusing of attention on the upgrades of the central offices has  
17 existed throughout the proceeding.

18

19 Q. ANOTHER REASON THAT THE COMPANY GIVES FOR THIS NEW STUDY WAS TO  
20 BE RESPONSIVE TO THE COMMITTEE'S DISCOVERY REQUESTS. IS THIS NEW  
21 STUDY RESPONSIVE TO ANY OUTSTANDING COMMITTEE DATA REQUEST?

22 A. No. To the best of my knowledge, no party had requested a new  
23 economic study of these central office upgrades. All of the  
24 Committee's requests were specifically for information to  
25 properly correct the existing study.

5

1 Q. IS THERE ANOTHER POSSIBLE EXPLANATION?

2 A. Yes. Another possible explanation is the fact that the Company  
3 had originally filed a study which showed what they wanted it to  
4 show, that the office upgrades were uneconomic. However, after  
5 several rounds of discovery, that study, as corrected, proved  
6 that the central office replacement package was an economic  
7 replacement. This corrected result undercut the Company's claim  
8 that it was entitled to some additional reward for making these  
9 upgrades.

10

11 The new last minute study again conveniently makes it appear that  
12 this upgrade package is uneconomic. The Company also  
13 conveniently provided this study so late that there is no  
14 reasonable opportunity for the other parties to review and  
15 correct whatever problems exist in this new study.

16

17 In my opinion the major "problem" with the existing study from  
18 the Company's point of view was the fact that the other parties  
19 in the proceeding had a fair opportunity to review and correct  
20 it.

21

22 Q. SHOULD THE COMMISSION ASSUME THAT THIS NEW STUDY PROVIDED THE  
23 COMPANY IS VALID?

24 A. No. The original study provided by the Company was not valid, as  
25 originally provided. Therefore, there is no reason to assume  
26 that this new one is valid, as originally provided.

1

2 Q. IF ELECTROMECHANICAL UPGRADES WERE NOT ECONOMIC, WOULD THAT PUT  
3 THE SHAREHOLDERS AT RISK UNDER CONVENTIONAL REGULATION?

4 A. No. If the Commission orders the replacement of the  
5 electromechanical offices, this investment would appropriately be  
6 part of the Company's rate case. The Company would be allowed to  
7 earn a fair and reasonable return on this shareholder investment.

8

9 Q. DOES THIS CONCLUDE YOUR SUPPLEMENTAL SURREBUTTAL TESTIMONY?

10 A. Yes.

Utah

Docket No. 90-049-06/90-049-03  
CCS02-002.15

INTERVENOR: Committee of Consumer Services

REQUEST NO. 002.15  
14607

- (a) Please provide all studies of the economic benefit of replacing the step by step or other electromechanical offices with digital central offices.
- (b) Please provide the summary sheet which shows the overall economic long term benefit of replacing these step by step or other electromechanical central offices.
- (c) Please provide an explanation of the significance of the results. For example, if terms such as "net present value" or "net present worth of expenditures" are used, please explain whether a positive "net present value" or "net present worth of expenditures" indicates that the new equipment would be less expensive than the existing step by step equipment over the long term.

RESPONSE:

- (a) Proprietary Attachment A contains the only cost study information available on the currently proposed office replacements. The input for this information consists of results of generic replacement studies done in 1988, for which only the summary of results remains. Proprietary Attachment B shows these results for the offices in the Plan, depicting the Net Present Worth of Expenditures (NPWE) for both the Present Method of Operation (PMO or Plan 1) and the office replacements (Plan 2), by office. The studies which developed the NPWE numbers are 20-year studies.

Note that proprietary/confidential Attachments A & B are being provided pursuant to the terms of the Protective Order.

Shown in Attachment A are the offices the Plan proposes for modernization and the cost differences (or cost advantages/disadvantages) between the PMO and the office modernizations. The numbers showing cost advantages and disadvantages are the result of subtracting the NPWE of the office modernizations (Plan 2) from the NPWE of the PMO (Plan 1).

- (b) Please see the response to (a) above.
- (c) The numbers shown in Attachment A indicate that only the first seven offices listed would be more cost-economical to replace than to continue with the PMO. However, given that the largest cost advantage among those offices is only \$56,000 (NPWE over

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CCS02-002.15

20-years), even they are not attractive candidates for replacement without significant new revenues, because:

1. The offices are currently providing adequate service.
2. While the opportunity for "significant new revenues" may be provided by office replacements, such revenues would not be guaranteed, and they would not be generated without the additional investment of time and effort on the Company's part.
3. Any new revenues from the replacements would involve greater risk than revenues generated with the existing technology. The risk is greater because the new revenues would come from services that are discretionary to customers. In contrast, the existing revenues come from basic services to which the customers now subscribe and upon which a new office would have no impact.

The remaining offices (numbers 8 through 46) are not cost-economical, and would thus require even greater revenue opportunities than the first seven, to offset the increased risk and to justified replacement.

The proposed Incentive Regulation Plan provides the Company with incentives and opportunities to generate and retain a portion of increased revenues commensurate with the economic and risk conditions of the office modernizations. In addition, customers benefit in ways that otherwise would not be available, as the Company experiences more success under such an approach.



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INTERVENOR: Committee of Consumer Services

REQUEST NO. 002.15  
14607

- sq.
- (a) Please provide all studies of the economic benefit of replacing the step by step or other electromechanical offices with digital central offices.
  - (b) Please provide the summary sheet which shows the overall economic long term benefit of replacing these step by step or other electromechanical central offices.
  - (c) Please provide an explanation of the significance of the results. For example, if terms such as "net present value" or "net present worth of expenditures" are used, please explain whether a positive "net present value" or "net present worth of expenditures" indicates that the new equipment would be less expensive than the existing step by step equipment over the long term.

RESPONSE:

UPDATED 9/28/90

Proprietary Attachment Bu is being provided as a total replacement to Attachment B, which had been provided in the original response. In the original Attachment B, page 1 had been omitted in error. This attachment is being provided pursuant to the terms of the Protective Order.

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Docket No. 90-049-06/90-049-03  
CCS10-010.1

INTERVENOR: Committee of Consumer Services

REQUEST NO. 010.1  
15206

The response to Request CCS 2.15 was updated 9-28-90 and provides an analysis of the economic benefits of replacing the electro-mechanical offices with digital central offices.

- (a) The document provided is an analysis without revenues. Please provide the economic analysis requested in Request CCS 2.15, with the effect the additional revenues included in the economic analysis (additional revenues are from additional services which can be provided from the digital equipment such as custom calling services).
- (b) In this study, what discount rate was used in order to bring future expenses back to the present?
- (c) How many lines in total were in service in all of the offices included in this analysis?
- (d) The document provided in the second column is entitled "date". Is it correct that is the date on which the central office would be replaced under Plan 2?
- (e) Under the present method of operation, for Plan 1 please provide the date on which each office was to be replaced by a digital central office.
- (f) Please provide the number of access lines in service for each central office on this list.

RESPONSE:

- (a) The response to CCS 2.15 contained no revenue estimations because none had been developed for the currently proposed list of office replacements. On the other hand, a cost analysis was available for the proposed offices and was provided in response to CCS 2.15.

The only revenue estimate that is available was prepared on an aggregate basis for a larger list of offices than is currently proposed. A special study would be required to attempt to determine what portion of the previous revenue estimate might apply to the current proposal or to develop

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new revenue estimates that would apply to the current proposal.

- (b) 12.5 percent.
- (c) 72,766 Network Access Lines (NAL).
- (d) Yes, as viewed at the time the analysis was done.
- (e) Plan 1 or PMO (Present Method of Operation) assumes that the existing technology would be continued for the 20-year study period. Under that assumption, building additions would be provided when needed to provide additional floor space. Consequently, there were no replacement dates within the 20-year study period for replacement of the offices with digital technology.
- (f) Please refer to Attachment A, which is a list including the listed central offices and the access lines in service.

Print Date 10/09/90

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Docket No. 90-049-06/90-049-03

CCS10-010.1

Attachment A

INSTALLED SWITCHING CAPACITY BY TECHNOLOGY TYPE AS OF EOY 1988  
USING DECEMBER 1988 NAL FIGURES.

OFFICE	TYPE	A/D	NAL	A-LINES	D-LINES	EM LINES	SPC LINES
1 PARK CITY	5XB	A	8368	8368	0	8368	0
2 OGDEN NORTH	5XB	A	7392	7392	0	7392	0
✓ 3 VERNAL	5XB	A	6988	6988	0	6988	0
✓ 4 TOOELE	5XB	A	6356	6356	0	6356	0
✓ 5 PRICE	5XB	A	6355	6355	0	6355	0
6 OGDEN WEST	5XB	A	6305	6305	0	6305	0
7 SPRINGVILLE	5XS	A	5880	5880	0	5880	0
✓ 8 SPANISH FORK	5XS	A	4732	4732	0	4732	0
✓ 9 HEBER	5XB	A	3691	3691	0	3691	0
✓ 10 RICHFIELD	5XS	A	3421	3421	0	3421	0
✓ 11 PAYSON	350	A	3381	3381	0	3381	0
✓ 12 LEHI	350	A	3149	3149	0	3149	0
✓ 13 SMITHFIELD	355	A	3120	3120	0	3120	0
✓ 14 ROOSEVELT	355	A	2948	2948	0	2948	0
✓ 15 HYRUM	355	A	2550	2550	0	2550	0
16 HURRICANE	355	A	2180	2180	0	2180	0
17 KANAB	355	A	2080	2080	0	2080	0
✓ 18 HELPER	355	A	1538	1538	0	1538	0
19 GRANTSVILLE	355	A	1471	1471	0	1471	0
✓ 20 SALINA	355	A	1421	1421	0	1421	0
✓ 21 RICHMOND	355	A	1293	1293	0	1293	0
✓ 22 MORGAN	355	A	1283	1283	0	1283	0
✓ 23 MOUNT PLEASANT	355	A	1256	1256	0	1256	0
✓ 24 COALVILLE	355	A	1192	1192	0	1192	0
✓ 25 BEAVER	355	A	1157	1157	0	1157	0
✓ 26 MONROE	355	A	1078	1078	0	1078	0
✓ 27 PARowan	355	A	985	985	0	985	0
✓ 28 EPHRAIM	355	A	942	942	0	942	0
✓ 29 PANGUITCH	355	A	785	785	0	785	0
✓ 30 HUNTINGTON	355	A	750	750	0	750	0
✓ 31 EAST CARSON	355	A	708	708	0	708	0
✓ 32 DUCHESNE	355	A	645	645	0	645	0
✓ 33 MILFORD	355	A	602	602	0	602	0
✓ 34 GREEN RIVER	355	A	550	550	0	550	0
✓ 35 HENDOVER	355	A	505	505	0	505	0
✓ 36 MOUNTAIN GREEN	355	A	500	500	0	500	0
✓ 37 VETO	355	A	499	499	0	499	0
✓ 38 CORINNE	356	A	450	450	0	450	0
✓ 39 GARDEN CITY	355	A	426	426	0	426	0
✓ 40 LOA	355	A	375	375	0	375	0
✓ 41 BICKNELL	355	A	368	368	0	368	0
✓ 42 ENTERPRISE	355	A	347	347	0	347	0
✓ 43 SPRINGDALE	355	A	331	331	0	331	0
✓ 44 CIRCLEVILLE	355	A	296	296	0	296	0
✓ 45 GOSHEN	355	A	285	285	0	285	0
✓ 46 EUREKA	355	A	252	252	0	252	0
✓ 47 MINERSVILLE	355	A	219	219	0	219	0
✓ 48 MARYSVILLE	355	A	179	179	0	179	0
✓ 49 LEEDS	355	A	155	155	0	155	0
✓ 50 BRUCE CANYON	355	A	128	128	0	128	0
✓ 51 HAMSVILLE	355	A	102	102	0	102	0



INSTALLED SWITCHING CAPACITY BY TECHNOLOGY TYPE AS OF EOY 1988  
USING DECEMBER 1988 NAL FIGURES.

OFFICE	TYPE	A/D	NAL	A-LINES	D-LINES	BM LINES	SPC LINES
✓ 52 HATCH	355	A	97	97	0	97	0
✓ 53 SCOTFIELD	355	A	92	92	0	92	0
✓ 54 MIAMATRA	355	A	43	43	0	43	0
TOTALS			102182	102182	0	102182	0

Utah

Docket No. 90-049-06/90-049-03  
CCS14-014.1

INTERVENOR: Committee of Consumer Services

REQUEST NO. 014.1  
15514

The response to CCS10-010.1 part (a) states that the only revenue estimate that is available was prepared on an aggregate basis for a larger list of offices than is currently proposed. Please provide the following information pertaining to this "larger list of offices":

- (a) The total lines in service of all of the offices included in this larger list.
- (b) The NPWE total for all of these offices under each of the plans (base plan and modified plan).
- (c) Provide the amount of NPWE which was attributable to the additional revenues in the plan in which the additional revenues from additional services were included.
- (d) Please provide the NPWE for additional revenues resulting from custom calling and other additional services which are available under the new type of switch as compared to the older type of switch which were included in the modified plan (the plan which anticipated more rapid replacement of the electromechanical offices with digital central offices.)
- (e) If there was any NPWE for additional revenues resulting from custom calling and other additional services which are available from digital central offices which are not available from the electromechanical offices which were included in the base plan, please provide the amount of those revenues and an explanation as to why they existed in the base plan.

RESPONSE:

In the referenced response to CCS10-010.1, the Company stated:

"The only revenue estimate that is available was prepared on an aggregate basis for a larger list of offices than is currently proposed. A special study would be required to attempt to determine what portion of the previous revenue estimate might apply to the current proposal or to develop new revenue estimates that would apply to the current proposal."

Utah  
Docket No. 90-049-06/90-049-03  
CCS14-014.1

In an effort to be responsive to the intent of the Committee's current request, as well as request CCS10-010.1, USWC has developed an estimate of revenue that would apply to the current proposal.

- (a) The total number of lines in service for the offices currently proposed by the Company for replacement, as of the end of the year in which the original revenue estimates were made (1988) was 62,170.
- (b) As given in Attachment B of USWC's response to CCS02-002.15, the total estimated net present worth of expenditures (NPWE) for the base and modified plans were \$41,807,600 and \$49,950,200, respectively. Additionally, as stated on page 24 of Mr. Selander's testimony, Lehi has become a "hard trigger", and Payson, Spanish Fork, and other offices were being monitored. Since the time of that statement, Payson, Spanish Fork, Corrine, and Wendover have become firm candidates for replacements. Along with Lehi, USWC plans to replace these offices in 1991, regardless of the status of the overall modernization proposal in this docket.

Consequently, the original list of offices has become smaller, in terms of the offices that are relevant to the Company's incentive regulation and modernization proposal. The NPWEs for the remaining offices for the base and modified plans then become \$34,632,600 and \$42,071,900, respectively. (The corresponding number of lines for this "smaller" list is 49,953.)

- (c) The 20-year net present worth (NPW) of the revenue estimates applicable to the offices in the current proposal is \$12,525,800. For the "smaller list" of offices that will remain after the planned 1991 replacements, the NPW of revenue estimates is \$10,064,300. This amount of revenue, spread to the offices involved, yields the following:
  - Three of the offices are clearly economical, though without any trigger to warrant priority attention (such as problems with capacity or service adequacy).
  - Nineteen of the offices are marginally economical and also have no "triggering" condition to warrant priority attention.
  - The remaining nineteen offices are clearly not economical, even with a twenty percent increase in revenues.

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CCS14-014.1

As an overall 41-office package, the entire program is marginally economical, though suboptimal, in terms of shareholder and ratepayer impacts. (From a sensitivity analysis, a decrease in the revenue estimates of less than twenty percent would make the overall package marginally uneconomical). It is this condition that the Incentive Regulation Plan offsets and that justifies the investments, if they are made in conjunction with that Plan.

- (d) See the response to subpart (c) above.
- (e) There were no such revenues included in the base plan.

## Addendum 10

PSC Order Denying Stay dated August 30, 1991, in Docket  
Nos. 90-049-03 and 90-049-06

DOCKETED

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application	)	
of U S WEST Communications for	)	<u>DOCKET NO. 90-049-03</u>
Approval of an Incentive	)	
Regulation Plan.	)	
	)	
In the Matter of the Investigation	)	<u>DOCKET NO. 90-049-06</u>
into the Reasonableness of the	)	
Rates and Charges of U S WEST	)	<u>ORDER DENYING STAY</u>
Communications.	)	
	)	
	)	

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ISSUED: August 30, 1991

BY THE COMMISSION:

In this matter U S WEST Communications (USWC) has requested that the Commission stay the modernization portion of its June 19, 1991 order pending an appeal of the order by USWC to the Utah Supreme Court. As formally proposed by the Company, the modernization plan approved by the Commission consists of rural central office upgrades, extension of the fiber optic backbone, and fiber facilities for distance learning.

USWC seeks a stay at the Commission pursuant to 63-46b-18 of the Utah Administrative Procedures Act which imposes on the utility the obligation of exhausting its administrative remedies prior to approaching the Supreme Court with a request.

In determining whether or not the stay should be granted, the Commission considers what if any harm will come to USWC if the stay were not granted and the Commission's order is overturned by the

005745

Court.

In support of its request, USWC has furnished the Commission with an affidavit executed by Mr. Robert C. Fuehr, the Utah Vice President for USWC. In essence Mr. Fuehr states that if the modernization requirements of the order are not stayed and the Commission's order is found deficient by the Court, USWC will have been required to expend capital it would not otherwise expend and will be forced to forego more profitable investment opportunities.

"The Commission has stated that it will allow a reasonable return to be earned on these investments and that, therefore, they are without risk. Such an approach fails to recognize that USWC and its parent US WEST, Inc. as managers of the capital on behalf of investors have a variety of options as to the use and deployment of capital. Among these options are the use of capital in projects with a greater return potential than a regulated utility return. Thus, the fact that USWC may be given the opportunity to earn a regulated utility return does not obviate the myriad other potential investment opportunities."

While this statement is made in the context of a request for a stay of our order, nonetheless, it seems to reflect USWC's present attitude towards utility investments generally. In our judgment this attitude stands traditional regulation on its head. It is apparently the Company's view that utility investment is simply one among many investment opportunities. While it used to be that for a monopoly provider a public service obligation was paramount, now, in Mr. Fuehr's view, the provider is free to play one investment option against another, including utility

investment. The Commission is therefore put in the position of having to bid, literally, against other non-utility investment options, real or imagined, in order to insure that utility investments required for service adequacy are made.

The only real fault which the Company finds with the modernization investments we have ordered is that we haven't agreed to USWC's proposed incentive plan, which, in our judgment, would have resulted in windfall profits for USWC. However, at the outset of this case, USWC pitched the very same investments ordered by the Commission, claiming that these investments were necessary and would prove to be highly beneficial, and its witnesses, as well as others, justified and substantiated those investments during the hearings. Now it is clear that what USWC really meant was that the upgrades were needed only if the Company were allowed to make as much money as it wants. When the Commission determined that something less was appropriate, then, magically, the upgrades weren't really necessary; they were simply a luxury offered as bait for the Company's incentive plan.

The fact of the matter is that USWC has planned to make these upgrades, at least the rural central office upgrades and the fiber optic extension to St. George, all along. The imposition of our order merely advances the timing of the upgrades by a matter of months. This is germane to the consideration of the claimed harm. Any such harm is limited to the difference between two investment



streams, that previously planned by the Company and that approved in this docket.

Furthermore, we do not believe that the loss of allegedly more lucrative opportunities is a justification for a stay given the history of USWC's overearnings in Utah over the past five or six years. The Company has earned nearly 17% annually on its Utah investments over that period of time and we doubt very much that actual returns in the near future will be significantly lower. It is worth noting that in each of its rate cases for some years now the Company has projected a relatively dismal return on its investment and the actual return has been well above that authorized by this Commission. Therefore, the likelihood that the Company will lose substantial revenues by making a relatively modest investment in Utah as opposed to its "pie-in-the-sky" investments elsewhere is minimal.

Mr. Fuehr's statement is further flawed by the fact that it assumes that USWC has very limited access to financial resources and the required Utah utility investments would displace much more profitable investment opportunities elsewhere. There is absolutely no evidence on the record to show that USWC cannot go to the financial markets at any time and obtain the capital it desires on highly favorable terms.

In addition, it is an established and well-known fact that utility investments are relatively safe, low-risk and dependable.

Nonetheless, Mr. Fuehr's statement would require that we assume that these other supposedly more lucrative investments are equally low-risk, safe and dependable. In establishing the allowed return on investment, we fully consider risk, guided by the need for risk-return parity. Mr. Fuehr fails to note that the non-utility investments the Company may make will offer higher return only if greater risk is assumed.

Nor does the USWC argument take into account the accelerated depreciation which the Company has enjoyed on its investments in utility service over the past five years. The accelerated depreciation was intended to make new utility investment more attractive to USWC but the investments haven't been made even though the Company has had the benefit of the increased revenues from the depreciation.

Even if USWC's argument about lost investment opportunities made any sense at all, our order allows the Company 54 months within which to make the required upgrades in rural central offices and in the fiber link from Nephi to St. George. It stretches the imagination to argue that this matter will be unresolved by the Court well before the 54 months expire. Thus, whatever harm the Company believes it will suffer certainly can't be said to be immediate and in all likelihood would never occur.

The educational fiber optic extensions were hortatory only; we have set no deadline for the extensions and the Company need only

file a plan with us in whatever detail is reasonable under the circumstances.

In summary, we conclude that we must deny the request for a stay in that there is no reasonable likelihood of any substantial harm to USWC from the order we have issued: first, because the Company has earned well in excess of its authorized rate of return in Utah for some time and there is no real likelihood that that will change in the near future; second, because the Company is not limited in its access to financial resources as it has implied; third, USWC has not taken into account the low-risk nature of utility investment and the accelerated depreciation it has been allowed; fourth, the order allows the Company 54 months time within which to accomplish the upgrades, more than enough time to request and receive from the Court a pronouncement in this case and, fifth, because the Company has planned to accomplish the central office and fiber upgrades anyway and will be required merely to advance the timing somewhat.

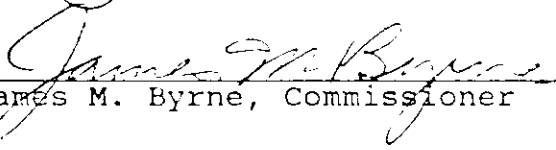
Based upon the foregoing, the Commission will order the following:

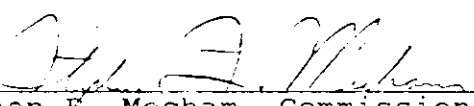
ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that the request for a stay of the modernization portion of the Commission's order of June 19, 1991 be and the same is hereby denied.

DATED in Salt Lake City, Utah this 30th day of August, 1991.

  
\_\_\_\_\_  
Brian T. Stewart, Chairman

  
\_\_\_\_\_  
James M. Byrne, Commissioner

  
\_\_\_\_\_  
Stephen F. Mecham, Commissioner

Attest:

  
\_\_\_\_\_  
Stephen C. Hewlett, Commission Secretary